S. HRG. 100-1065

THE MAJOR FRAUD ACT, AND THE GOVERNMENT FRAUD LAW ENFORCEMENT ACT OF 1987

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

H.R. 3911

A BILL TO AMEND TITLE 18, UNITED STATES CODE, TO PROVIDE INCREASED PENALTIES FOR CERTAIN MAJOR FRAUDS AGAINST THE UNITED STATES

AND

S. 1958

A BILL TO ESTABLISH REGIONAL GOVERNMENT FRAUD LAW ENFORCEMENT UNITS FOR EFFECTIVE INVESTIGATION AND PROSECUTION OF FRAUD AGAINST THE GOVERNMENT

JULY 12, 1988

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TUESDAY, JULY 12, 1988

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 9:42 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Howard M. Metzenbaum (acting chairman) presiding.

Also present: Senators DeConcini, Grassley, Simon and Specter.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator METZENBAUM. This morning this committee addresses itself to the issue of the passage of the Major Fraud Act, H.R. 3911, and S. 1958, the Government Fraud Law Enforcement Act of 1987.

Elimination of government fraud, waste and abuse has been a campaign promise and policy goal of every modern administration, Democratic and Republican. It enjoys great popular support, and has been the object of countless commission studies, new anti-fraud laws, and reportedly intensified law enforcement reports.

But despite all the studies, all the talk, all the claimed accomplishments, the Pentagon scandal shows that procurement fraud, particularly in the military remains an epidemic out of control.

The corruption is massive and systemic. It will lead as it should to yet another round of debate on defense acquisition reform.

New measures will have to be considered and implemented. But that work will largely be done in the Armed Services Committee, and on the House and Senate Floors.

As we get into this subject, it reminds me of a time when Senators Armstrong, Warner and myself went down to see Secretary Weinberger, and Deputy Secretary Carlucci, to talk about the problems of procurement; not fraud, but just failure to use proper procurement practices.

And I remember after that there came out the 32 new initiatives of the Department of Defense for procurement.

And we had gone down to talk about using competitive bidding. And interestingly enough, they had made no improvement, suggested no improvement, as it pertained to competitive bidding.

And I called Mr. Carlucci at that time. He was deputy director. And I said to him, how come you didn't say anything about competitive bidding in the procurement process? Oh, it was an oversight. So then it went in.

And I remember also when Senator Goldwater and I sued the Navy by reason of their procurement practices in connection with a particular plane. And notwithstanding the fact that Senator Goldwater at that time was Chairman of the Armed Services Committee; notwithstanding the fact that we had gone to court to do something about it, we still could not beat the processes of the government, processes of the Navy, that didn't want to use anything except this one particular plane.

And so you get the feeling that you're swimming upstream when you're dealing with the Department of Defense in this area.

And one can't overlook the fact that it wasn't too many years ago when a number of defense contractors were suspended as far as their right to bid on contracts because of their involvement in defense and fraudulent practices and inappropriate practices; and then suddenly overnight the government reversed itself and said, well, we have nowhere else to get the equipment. And so they just forgot about it entirely.

And that reminds us, that when we take a look at what happened just yesterday, we find that, when the very same defense contractors who had been suspended, all of that is suddenly changed, and the Department of Defense reverses itself.

The job of this committee is not to reform the system, but to consider ways of deterring and penalizing the human behavior that corrupts it. For while the corruption is systemic, what lies at its root is old fashioned greed.

We cannot eliminate greed, but we can make it expensive; very expensive. We can beef up the government's ability to uncover and prosecute fraudulent schemes inspired by greed.

And we can consider tightening revolving door restrictions to reduce the financial temptations that incite greed and compromise the integrity of Federal procurement officials.

H.R. 3911, passed unanimously by the House—and I congratulate you, Congressman Hughes, for your leadership in this area—would establish a new Federal procurement fraud offense for major contracts.

As Congressman Hughes, its chief sponsor, will explain more in a moment, it would stiffen penalties, lengthen the statute of limitations, and strengthen incentives and protections for corporate whistle blowers.

I consider these whistle blower provisions to be essential, as effective detection and prosecution of complex procurement fraud is almost impossible without inside tips.

Unless workers are encouraged and freed to come forward, the battle against fraud and corruption is already half lost.

I look forward to today's testimony on these and other provisions. I would be willing to consider any necessary revisions.

I would hope we can move forward promptly with this legislation.

S. 1958, which would establish a regional enforcement program for government fraud, also merits serious consideration. For a fuller explanation of the bill, I will defer to Senator Grassley, coauthor with Senator Proxmire, whom we are fortunate to have with us today.

And I might say parenthetically that this body is going to be a lesser body when my good friend, Bill Proxmire, leaves us. Because he's been a voice of reason and a voice of outrage when there was a reason to be outraged over a period of many years.

And we will be a lesser body, and not nearly as effective in seeking out some of the issues to which he has addressed himself over the years.

And I might also say that my friend to my left here who is usually on my right, Senator Grassley, has certainly distinguished himself in so many ways by his willingness to speak out regardless of the politics of the matter when he's found ripoffs of the Federal Government, and I am looking to hearing from you very shortly.

But before we turn to Senator Grassley, let me emphasize how important I think it is that the Congress lead and act on this issue.

The American people, nearly 90 percent according to recent polls, are demanding that more be done to fight waste, fraud and abuse in government. While the Pentagon bribery scandal is not the immediate focus of this hearing, it is a vivid backdrop and a reminder of the crisis in our government procurement system, and of the threat of that crisis to our national security, and to public trust in government.

Unless the Congress and the administration act effectively and act now, these pillars of our democracy will suffer serious and lasting damage.

I think it is an indication of the determination of Congress to act in this area that the Armed Services Committee is conducting a hearing, I think at this very moment, along similar lines, although with respect to different phases of the problem as are we today.

Senator Grassley.

Senator GRASSLEY. Mr. Chairman, I thank you for your kind remarks about me; but more importantly, I want to associate myself with the remarks made on behalf of Senator Proxmire.

We need to remember that his leadership in this area goes back to protecting whistle blowers who were involved in the C-5A scandals.

Mr. Chairman, the current defense procurement investigation shows how widespread and potentially harmful this type of fraud can be to the national security and to the public trust.

The government has consistently been on the short end of the war against defense procurement fraud, despite pleas by the public and many of my colleagues in Congress to beef up government resources to fight this kind of fraud.

We're here today to put our money where our mouth is. The defense procurement fraud problem is insidious. It is characterized and driven by a set of values completely alien to the rest of America.

Competition, and its benefits, apparently are not a desired goal in the defense business. To win, you have to play the "insider" trading game.

Winning a contract seems to be based on who you know, not on what you can do. I call this "peek-a-boo" procurement; getting a peek at what it takes to win a contract.

What could be more anathema to the American way of life?

Now let's be very clear from the outset that the problem of defense procurement fraud is not a "Johnny-come-lately" phenomena. Defense procurement fraud is probably the world's second oldest profession.

There is enough history on defense procurement fraud over the centuries to fill an encyclopedia. Consequently, there is much to learn from history on the nature and the character of this type of fraud.

And from that learning, we can better understand what needs to be done if we're going to conquer it once and for all.

Let me read a quote relevant to a current investigation.

> Classified documents which are prohibited from ever leaving the DOD are regularly trafficked among private consultants; companies in the procurement industry; and military and civilian employees of the government.

This quote dates back to 1985 testimony delivered to this committee by a former DOD investigator named Robert Segal.

Mr. Segal's testimony related to the Justice Department's handling of the *GTE* case, of which Mr. Segal, who directed the investigation, was critical. According to Mr. Segal, the investigation included 25 major companies, not just GTE, and this point did not fall on deaf ears.

Now, lawyers for the defendants said that this was an everyday activity, that, "the government is attempting in this criminal prosecution to punish three individuals for engaging in conduct that was routine and pervasive, and that no one regarded as criminal at the time."

The *GTE* case resulted from a two-year investigation by the Defense Criminal Investigating Service (DCIS). Only recently did it become public that bribery was involved in that investigation, and that the DCIS investigation of 25 companies showed the same pervasive and potentially fraudulent activity as seen in the current probe.

But the Justice Department prosecuted only GTE, not fully understanding the magnitude of the case brought to them by DOD investigators. This is according to Mr. Segal and other investigators involved at that time.

Today, 3 years later, Mr. Segal's testimony is just as relevant as it was in 1985. Had the Justice Department understood the significance of the case presented to it by DOD investigators, the apparent routine and pervasive activity could have been brought out and addressed 3 years ago.

Mr. Chairman, let me refer to an op-ed piece that appeared in Sunday's Baltimore Sun. It's an historic account of defense fraud in this country, written by David Morrison of the National Journal.

Morrison notes that defense procurement fraud dates back to 1782, when Congress directed the Secretary of Finance, Robert Morris, to investigate procurement abuses that occurred during the Revolutionary War.

Morrison recounts similar instances in 1861, during the Civil War; 1896, during the Spanish American War; 1934, following the First World War; 1941, with the Truman Commission, in the Second World War; the Fitzhugh panel of 1970, and the Packard Commission of 1986.

The problem has surfaced many times over the years, and many Commissions have come along suggesting the same remedy to the same problems.

This is clearly an historical problem, Mr. Chairman. But it makes us wonder why we can't seem to break the code on solving such a well-documented problem.

The reason in my mind that the Commissions often do not work is that they are sometimes intended as a large "valium" for the body politic.

Designed to tranquilize an outraged public, their solutions seldom cure the ills, because the prescription is to erode checks and balances in the defense management structure, rather than enhance those checks and balances.

With the Packard Commission, two examples come to mind. One is a self-policing policy by contract. Does anyone who has read the Morrison piece truly believe that self-policing will work?

The second example is the establishment of an acquisitions "czar". How can there be internal checks and balances when all the performance functions come under one office?

Without true independence among the functions responsible for monitoring performance, the system is ripe for manipulation and collusive fraud.

So what is the solution, Mr. Chairman? I would like to once again refer to the op-ed piece of David Morrison, who writes:

> An historical perspective suggests that there is little that is truly new in the scandal, and that eternal vigilance will always be the price of efficiency and of ethical practices in the $160 billion per year business for stocking the arsenal of democracy.

I would say, Mr. Chairman, that that means it's time to move government's resources to the front line, and fight fire with fire!

Today, this committee considers two bills that would be part of the process of constant vigilance. I welcome today's expert testimony, and trust that the committee will act expeditiously to respond to a problem that all of us are concerned about, and that we can certainly do something about.

Thank you, Mr. Chairman.

Senator METZENBAUM. Also we are very pleased to have Senator DeConcini with us this morning. Senator DeConcini is also one of those whose voice has been raised in ire and concern on so many occasions having to do with this very problem.

We are happy to have you with us this morning.

Senator DECONCINI. Mr. Chairman, thank you. And thank you for holding these hearings, and thank you Representative Hughes for your leadership in the House.

And may I compliment again, as you have so well pointed out, Senator Proxmire's leadership in this area. At times he has been a voice in the wilderness, but often has been heard, and certainly by this Senator.

The recent FBI investigation has made us all well aware of the issue of procurement fraud in the Department of Defense and procurement fraud in general.

Earlier this year the Government Accounting Office studied 148 open cases reported to the Secretary of Defense from April 1, 1985, to March 31, 1986.

The GAO estimated the losses due to procurement fraud in those cases alone at at least $387 million. In 1985, Deputy Attorney General Toensing testified before the subcommittee on administrative practices and procedures that 45 of the top 100 Department of Defense contractors were under criminal investigation.

Apparently not much has changed in these 3 years. In the last few weeks, it has been reported that 39 of the 46 defense contractors who had agreed to police their own compliance with procurement rules have come under investigation for fraud, including criminal fraud.

As a result of the recent investigation, the Justice Department has issued 278 subpoenas, 42 search warrants, and it is likely that even more will follow.

Defense Secretary Frank Carlucci has ordered a freeze on approximately $1 billion in defense contracts. The Senate Government Affairs Committee and the House Armed Services Committee recently held hearings on the procurement process.

The Senate Armed Services Committee is also holding hearings today on the issue.

Whatever the final outcome of these investigations, it appears that the current system of monitoring the procurement process is not working. We have before the committee legislation that attempts to address problems associated with Federal procurement fraud in contracts of $1 million or more.

The bill amends Title 18 of the United States Code by increasing penalties for certain major frauds against the United States. Specifically the bill provides jail terms, fines, and a whistle-blower provision in the event of procurement frauds in excess of $1 million.

The FBI probe into procurement practices appears to be serving as a catalyst for quick passage of this type of legislation. I would caution, however, that an objective approach to the problem must be taken.

Although I agree that we have to do something and steps are needed to combat procurement fraud, I would not want to overreact simply because the political winds are blowing in favor of the extreme measures.

Mr. Chairman, I want to compliment you for setting aside today with your busy schedule to review these two bills, S. 1958 and H.R. 3911. I think these are most significant pieces of legislation, and your leadership in getting them through the Judiciary Committee is going to be crucial.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you very much, Senator DeConcini.

Before I call the first panel, I wish to place opening statements by Senators Thurmond and Hatch in the record.

[Prepared statements follow:]

STATEMENT BY SENATOR STROM THURMOND(R-S.C.) BEFORE THE SENATE JUDICIARY COMMITTEE, REFERENCE-FULL COMMITTEE HEARING ON H.R. 3911-MAJOR FRAUD ACT, AND S. 1958- GOVERNMENT FRAUD LAW ENFORCEMENT ACT, 226 DIRKSEN SENATE OFFICE BUILDING, TUESDAY, JULY 12, 1988, 9:30 AM.

Mr. Chairman:

I am pleased to be here today at this Judiciary Committee hearing on H.R. 3911, the Major Fraud Act, and S. 1958, the Government Fraud Law Enforcement Act. Both of these bills address the problems that have arisen with regard to fraud in the area of government contracting.

It is extremely disturbing as we continue to learn of instances of fraud in connection with government procurement contracts. In this time of belt-tightening and budget cutting, any waste of money, especially as a result of fraud, is inexcusable. The American people are the real losers in these situations because money which could be used for legitimate programs and purposes is being needlessly wasted. In 1986, Congress passed the False Claims Amendments Act and the Program Fraud Civil Remedies Act to strengthen the current laws with regard to such fraud in the procurement process. However, allegations of fraud in this area continue. Therefore, it is appropriate to consider whether additional legislation is necessary.

The two bills that are the focus of this hearing propose different approaches to this problem. H.R. 3911 establishes stiff criminal penalties for persons who defraud the government in connection with a contract for the procurement of property

or services. S. 1958 directs the Attorney General to establish regional task forces to investigate and prosecute program and procurement fraud. I look forward to hearing the testimony today on these bills. I am also interested in hearing the views of those present today as to how this legislation will work in conjunction with the laws enacted in 1986.

In closing, we must take strong, tough action which will stop abuse in the area of procurement in order to ensure the integrity of the contracting process of the Federal Government.

STATEMENT OF SENATOR ORRIN G. HATCH

HEARING ON MAJOR FRAUD ACT, H.R. 3911

GOVERNMENT FRAUD LAW ENFORCEMENT ACT, S. 1958

SENATE COMMITTEE ON THE JUDICIARY

JULY 12, 1988

Mr. Chairman, this morning we examine legislation to combat fraud against the federal government. Recent newspaper accounts of pervasive misconduct by contractors, consultants, and DoD officials against the federal government have once again fueled concern for assurance that these abuses of the system are fully and appropriately punished. Therefore, it is important at this time for the Committee to examine the adequacy of the law enforcement tools, criminal penalties, and civil remedies available to fight fraud against the government.

At the outset, it is useful to note the considerable body of law currently available to battle procurement fraud. In addition to suspension and debarment for government contracting, which is possibly the greatest deterrent to contractor fraud, there are some thirteen federal statutes and other remedies that could be applicable to the information release and trading alleged in the current Pentagon fraud scandal.

This Committee was active in negotiating and passing the False Claims Act Amendments in 1986 which raised both criminal and civil penalties for violations involving false claims, provided protections for "whistleblowers," and strengthened provisions relating to "bounty hunter" qui tam suits involving government fraud. This bill constitutes an important prosecutorial tool in fighting procurement fraud. In fact, we were told in recent Judiciary Committee hearings that the three major fraud bills passed in 1986, the Program Fraud Civil Remedies Act, the Anti-Kickback Enforcement Act, as well as the False Claims Act Amendments have proved successful in fighting fraud against the federal government. Moreover, in the Criminal Fines Improvements act of 1987, Congress enacted legislation that permits the imposition of fines of up to twice the gross gain to the defendant or twice the gross loss to the United States.

While there is general agreement that action must be taken to curtail procurement fraud, a number of criticisms have been raised with respect to the drafting of the Major Fraud Act, H.R. 3911. Given the volume of existing law applicable to procurement fraud, some have expressed concern that provisions of the Major Fraud Act are duplicative of existing law. Another concern raised involves the intent standard of "knowingly" found in the bill. Given that a violator could be imprisoned for ten years upon a guilty verdict, some have

argued that a specific intent standard such as "knowingly and willfully" is a more appropriate standard.

In addition, concern is raised that the bill would establish excessive penalties-- penalties that are not related to the severity of the underlying crime and not consistent with penalties imposed for other serious crimes. Finally, the bill extends the statute of limitations for procurement fraud actions from five to seven years and some argue that this extension is contrary to the government's obligation to investigate and act expeditiously on suspected criminal activity.

With these concerns in mind, I intend to examine the testimony of the witnesses carefully. Procurement fraud is a serious problem and we must craft legislation that is both effective and workable.

Senator METZENBAUM. Senator Proxmire, with all those accolades you've had this morning, I don't know how you can do any better. We are delighted to hear you.

STATEMENT OF A PANEL CONSISTING OF HON. WILLIAM PROXMIRE, A U.S. SENATOR FROM THE STATE OF WISCONSIN, AND HON. WILLIAM J. HUGHES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Senator PROXMIRE. Well, thank you very much, Mr. Chairman. I want to thank all you gentlemen for your very kind remarks.

And I want to also thank you for holding hearings on defense fraud, and I appreciate the opportunity to testify.

I am here primarily to testify on S. 1958, the government fraud law enforcement act, introduced by Senator Grassley and myself last December.

The purpose of this bill is to establish regional fraud law enforcement units within the Department of Justice to achieve greater effectiveness in the investigation and prosecution of fraud against the U.S. Government.

Now you three Senators have been concerned for years about abuses in defense contracting. There are many officials and experts who have insisted that the defense contract system is basically sound, and that the abuses have been uncovered.

And they represent only isolated cases of horror stories. This argument has been used to frustrate efforts to fundamentally reform the system, although Congress has succeeded in legislating important improvements in recent years.

The recent disclosure of widespread defense fraud confirm what some of us have been saying about the seriousness and pervasiveness of this problem.

As you said, Mr. Chairman, a little earlier, other committees are holding hearings on defense contracting. In fact, you pointed out that one is being held this morning by the Armed Services Committee.

Those hearings are important, and I would hope that the military committees will consider the consequences of the scandal for the defense contract system.

But important as those hearings are, the hearings of the Senate Judiciary Committee are more important at the present time, and I want to tell you why.

The defense contract system needs to be reformed because of a number of problems. There is waste; there is mismanagement; there is inefficiency as well as abuses such as fraud and bribery.

But you cannot solve the problem of defense fraud without tightening up the criminal laws, and strengthening the mechanism for their enforcement. No matter what is done to improve defense contracting the process will be fatally flawed so long as the criminal laws are inadequate or not properly enforced.

Unfortunately, greed and cheating are universal. The crooks will always be with us. We can control illegality in defense contracting, but it requires good law enforcement to do it.

We are losing the war against defense fraud because law enforcement is not good enough.

I support increasing the penalties for defense fraud, but it makes little sense to strengthen the criminal laws if we do not strengthen the enforcement of the laws.

Stiffer penalties would be meaningless without more effective prosecution and more convictions.

My conclusion that law enforcement needs to be strengthened is well considered. It is based on many years of oversight investigation of defense contracting in the Joint Economic Committee, and many years of experience on the Senate defense appropriations subcommittee, on which I've served for almost 30 years.

I have personally investigated every phase of the defense contracting process, and have been involved in the uncovering of waste and mismanagement in numerous weapons programs, including the C-5A, the 688 class submarines, the F-14 aircraft and M-1 tanks.

Several of my investigations turned up allegations and evidence of fraud, and in the mid-1970s I pressed the Navy to refer a group of cases involving ship construction to the Justice Department.

In each instance the Justice Department fumbled the ball. Investigations dragged on for years, and were eventually dropped with an announcement that there was insufficient evidence for prosecution.

In some cases the statute of limitations ran. Two cases involving Lockheed and Newport News Shipbuilding took 5 years for the Justice Department to investigate.

A case involving General Dynamics was declined after 3 years of investigation; it's been reopened and investigated for another 2½ years.

The case involving Litton took 7 years to get to trial, and by that time, witnesses' memories had faded, and the company was acquitted on a technicality.

In 1984 new evidence came to light about the General Dynamics and Newport News cases. My subcommittee, the Joint Economic Committee, began hearings in the General Dynamics case in July of 1984.

And in the fall of that year, Senator Grassley and I combined our two subcommittee to probe both General Dynamics and Newport News.

One of the documents we uncovered was an internal Justice Department review of Navy claims investigations, conducted by the Office of Policy and Management Analysis of the Criminal Division.

The review looked at the Justice Department's handling of the General Dynamics case and two others involving Lockheed and Bath.

The report was highly critical of Justice for not properly supervising the cases; for not understanding at the outset how large and complex they were, for turnover of attorneys and investigators; and for lack of coordination with the Navy.

To obtain an independent assessment of the delays and other problems in the investigation and prosecution of these cases, I asked the General Accounting Office, GAO, to look into them.

Senator Grassley asked GAO to evaluate the efforts of the Defense Department procurement fraud unit, established by the Justice Department several years earlier.

In 1987 Senator Grassley and I asked GAO to look more generally into the Justice Department's overall management of defense fraud cases. In addition last year the staffs of Senator Grassley's office and my joint economic subcommittee produced a staff study of Justice's investigation of defense fraud based on an in-depth analysis of the Newport News case and the facts concerning the defense procurement fraud unit.

This series of reports documents one of the most extreme cases I've ever seen of government mismanagement. The most serious problems can be summarized as follows.

The Justice Department does not devote adequate resources to defense fraud cases. Justice says it gives defense fraud a high priority but does not follow through with the assignment of resources.

Number two, the Justice Department does not efficiently manage the resources that are assigned to defense fraud. The current GAO report provides an extensive account of Justice's mismanagement in this area.

Number three, there is inadequate cooperation among the principal government bodies involved in defense fraud cases, the main Justice Department, the U.S. Attorneys' offices, the FBI, the investigative services of the Pentagon, and the military services.

Now, as a consequence of these shortfalls, major investigations often lapse, and large backlogs of cases are building up in a number of U.S. attorneys offices.

In some of the largest U.S. attorney's offices, only one or two attorneys are assigned to defense fraud.

One such prosecutor recently told my staff that his office is drowning in defense fraud cases. They are simply unequipped to handle the workload.

Frequently attorneys who work on defense fraud also have other responsibilities. I have no doubt that the cases that ought to be prosecuted are not being prosecuted because of the shortage of attorneys.

Furthermore, the government is unable to adequately handle large, complex cases involving the giant defense contractors because of weaknesses in the existing law enforcement structure. Resources for combatting defense fraud need to be concentrated in the large metropolitan areas where most of the defense fraud cases are pending, not just in or near Washington.

The bill that Senator Grassley and I have introduced recognizes that prosecution of government fraud, including defense fraud, involves a specialized area of law. Effective law enforcement in this area requires stable and identifiable resources, and the maximum amount of cooperation between investigators, prosecutors, civil attorneys, and government specialists.

The bill establishes within the Justice Department no fewer than five government fraud investigative and prosecutive units to be located in regions around the country responsible for prosecuting cases under both the criminal and civil laws.

The precise location and number of the units would be determined by the Attorney General. And they would supplement, not replace, the Justice Department's fraud section.

In closing I want to emphasize two things. First, this is not a partisan problem. The Justice Department's weaknesses with regard to defense fraud cases, especially large, complicated cases involving major defense firms, did not begin in the Reagan administration. They stretch back over several administrations, Democratic and Republican.

No administration has distinguished itself by its efforts to combat defense fraud.

Second, in no way am I criticizing the attorneys and investigators and others in the trenches, so to speak, engaged in the war against defense fraud. There are many dedicated civil servants doing everything they can to carry out their responsibilities, often with inadequate resources at their command.

We owe those who have stayed in the fight for honest government a debt of gratitude.

Let me say just one more thing, Mr. Chairman. About 2 years ago the FBI set up a sting operation in which their agents offered bribes to 106 contractors in New Jersey and New York. These were municipalities, where the local official would buy services for paving and for other local activity.

Of those 106 bribe offers, 105 were accepted; 105. Only one was not accepted. Why wasn't that one accepted? Because it wasn't big enough. It wasn't big enough.

The reason I raise that point is that the only way you get at bribery is to go after and penalize the people who offer the bribes. That's what we have to do.

And we have to have—and believe me, as you know, these are corporations that are very well staffed. They have the best lawyers that money can buy. They know how to delay cases.

And we have to have the manpower, the force, the skill, the professionalism, to stand up to them. That's what we don't have now. We're going to continue to have bribery cases. They're going to continue to plague this country and hurt our taxpayers and shame our country unless we act on the kind of proposal that Senator Grassley and I have proposed.

Thank you.

[The prepared statement of Senator Proxmire follows:]

Statement On Defense Fraud
Presented by Senator William Proxmire
Before the Senate Judiciary Committee
July 12, 1988

I want to commend Senator Metzenbaum and the Senate Judiciary Committee for holding hearings on defense fraud, and I appreciate being invited to testify. I am here primarily to explain S. 1958, the Government Fraud Law Enforcement Act, introduced by Senator Grassley and myself last December. The purpose of this bill is to establish regional fraud law enforcement units within the Department of Justice to achieve greater effectiveness in the investigation and prosecution of fraud against the U.S. Government. Before going into the details of the bill, I want to say something about the current defense fraud scandal, how this issue relates to defense contracting, and the events that led up to the introduction of the Proxmire-Grassley bill.

Senator Metzenbaum, Senator Grassley, and other Members of Congress have been concerned for years about abuses in defense contracting. There are many officials and experts who have insisted that the defense contract system is basically sound and that the abuses that have been uncovered represent only isolated cases or "horror stories." This

argument has been used to frustrate efforts to fundamentally reform the system, although Congress has succeeded in legislating important improvements in recent years. The recent disclosures of widespread defense fraud confirm what some of us have been saying about the seriousness and pervasiveness of this problem.

Other committees are holding hearings on defense contracting in the wake of the recent scandal. Those hearings are important and I would hope that the military committees will consider the consequences of the scandal for the defense contract system. But important as those hearings are, the hearings of the Senate Judiciary Committee are more important at the present time.

The reason is this: the defense contract system needs to be reformed because of a number of problems. There is waste, mismanagement, and inefficiency as well as abuses such as fraud and bribery. But you cannot solve the problem of defense fraud without tightening up the criminal laws and strengthening the mechanism for their enforcement. No matter what is done to improve defense contracting, the process will be fatally flawed so long as the criminal laws are inadequate or not properly enforced.

Unfortunately, greed and cheating are universal. The crooks will always be with us. We can control illegality in defense contracting but it requires good law enforcement. We are losing the war against defense fraud because law enforcement is not good enough.

I support increasing the penalties for defense fraud. But it makes little sense to strengthen the criminal laws if we do not strengthen the enforcement of the laws. Stiffer penalties would be meaningless without more effective prosecution and more convictions.

My conclusion that law enforcement needs to be strengthened is well considered. It is based on many years of oversight investigations of defense contracting in the Joint Economic Committee and many years of experience on the Senate Defense Appropriations Subcommittee.

I have personally investigated every phase of the defense contracting process and have been involved in the uncovering of waste and mismanagment in numerous weapons programs including the C5A, the 688 class submarine, the F14 aircraft, and the M1 tank. Several of my investigations turned up allegations and evidence of fraud and in the mid-1970's I pressed the Navy to refer a group of cases involving ship construction to the Justice Department.

In each instance the Justice Department fumbled the ball. Investigations dragged on for years and were eventually dropped with an announcement that there was insufficient evidence for a prosecution. Two cases, involving Lockheed and Newport News Shipbuilding, took five years for the Justice Department to investigate. A case involving General Dynamics was declined after three years of investigations, then reopened and investigated for another two and a half years. A case involving Litton took seven years to get to trial and by that time witnesses memories had faded and the company was acquitted on a technicality.

In 1984 new evidence came to light about the General Dynamics and Newport News cases. My Subcommittee of the Joint Economic Committee began hearings into the General Dynamics case in July 1984, and in the Fall of that year Senator Grassley and I combined our two Subcommittees to probe both General Dynamics and Newport News.

One of the documents we uncovered was an internal Justice Department "Review of Navy Claims Investigations," conducted by the Office of Policy and Management Analysis of the Criminal Division. The review looked at the Justice Department's handling of the General Dynamics case and two others involving Lockheed and Bath. The report was highly

critical of Justice for not properly supervising the cases, for not understanding at the outset how large and complex they were, for turnover of attorneys and investigators, and for lack of coordination with the Navy.

To obtain an independent assessment of the delays and other problems in the investigation and prosecution of these cases, I asked the General Accounting Office to (GAO) look into them. Senator Grassley asked GAO to evaluate the efforts of the Defense Procurement Fraud Unit (DPFU), established by the Justice Department several years earlier. In 1987, Senator Grassley and I asked GAO to look more generally into the Justice Department's overall management of defense fraud cases. In addition, last year the staffs of Senator Grassley's office and my Joint Economic Subcommittee produced a staff study of Justice's investigations of defense fraud based on an in-depth analysis of the Newport News case and the facts concerning DPFU. This series of reports document one of the most extreme cases I have seen of government mismanagement.

The most serious problems can be summarized as follows:

1. The Justice Department does not devote adequate resources to defense fraud cases. Justice says it gives

defense fraud a high priority but it does not follow through with the assignment of resources.

2. The Justice Department does not efficiently manage the resources that are assigned to defense fraud. The current GAO report provides an extensive account of Justice's mismanagement in this area.

3. There is inadequate cooperation among the principal government bodies involved in defense fraud cases: the main Justice Department, the U.S.Attorney offices, the FBI, the investigative services of the Pentagon, and the military services.

As a consequence of these shortfalls, major investigations often lapse and large backlogs of cases are building up in a number of U.S.Attorney offices. In some of the largest U.S.Attorney offices only one or two attorneys are assigned to defense fraud. One such prosecutor recently told my staff that his office is drowning in defense fraud cases. They simply are unequipped to handle the workload. Frequently, attorneys who work on defense fraud also have other responsibilities. I have no doubt that cases that ought to be prosecuted are not being prosecuted because of the shortage of attorneys.

Furthermore, the government is unable to adequately handle large, complex cases involving the giant defense contractors because of weaknesses in the existing law enforcement structure. The resources for combating defense fraud need to be concentrated in the large metropolitan areas where most of the defense fraud cases are pending, not in Washington.

The bill that Senator Grassley and I have introduced recognizes that prosecution of government fraud including defense fraud involves a specialized area of law. Effective law enforcement in this area requires stable and identifiable resources and the maximum amount of cooperations between investigators, prosecutors, civil attorneys, and government specialists.

The bill establishes within the Justice Department no fewer than five government fraud investigative and prosecutive units to be located in regions around the country, responsible for prosecuting cases under both the criminal and civil laws. The precise location and number of the units would be determined by the Attorney General, and they would supplement not replace the Justice Department's Fraud Section.

In closing, I want to emphasize two things. First, this is not a partisan problem. The Justice Department's weaknesses with regard to defense fraud cases, especially large, complicated cases involving major defense firms, did not begin in the Reagan Administration. They stretch back over several Administrations, Democratic and Republican. No Administration has distinguished itself by its efforts to combat defense fraud.

Second, in no way am I criticizing the attorneys and investigators and others in the trenches, so to speak, engaged in the war against defense fraud. There are many dedicated civil servants doing everything they can to carry out their responsibilities, often with inadequate resources at their command. We owe those who have stayed in the fight for honest government a debt of gratitude.

Senator METZENBAUM. Thank you very much, Senator Proxmire. I had never heard that report about the 106 bribe offers, 105 of which were accepted.

Senator PROXMIRE. I'll be happy to make that available to you.

Senator METZENBAUM. I've asked my staff to follow through with you. I think that's just unbelievable and fantastic.

Senator PROXMIRE. It may be unbelievable, but it's true.

Senator METZENBAUM. Oh, I understand that. If it weren't you saying it, I would have difficulty with it. But it is incredible.

Congressman Hughes, you probably get some sort of accolade. My recollection is that your bill passed the House by some overwhelming margin. What was the count?

Mr. HUGHES. 419 to 0.

Senator METZENBAUM. Not bad. The others were home that day; they were not present.

Congressman Hughes, yours has been a voice of reason, logic and concern, and guts in Congress for a good many years. And I have had the privilege of working with you on some other areas as well.

I am just delighted to have you with us this morning. Maybe even apologize a little bit for the wordiness, starting first with myself and then all of my colleagues.

But my guess is, you've been around here long enough to understand that well.

STATEMENT OF HON. WILLIAM J. HUGHES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. HUGHES. Thank you, Mr. Chairman, and members of this distinguished committee for permitting me to testify on behalf of this bill, H.R. 3911, the Major Fraud Act of 1988, as it passed the House of Representatives.

H.R. 3911, which I introduced, passed unanimously at both the subcommittee and the full committee levels in the House Judiciary Committee, and on May 10, 1988, passed the House of Representatives by a vote of 419 to 0.

This bill grew out of hearings by the subcommittee on crime and a review of numerous other congressional, Department of Justice and Department of Defense investigations of procurement fraud over the last two decades.

I will not here reiterate the litany of successive scandals in spare parts, overhead overcharges, malfunctioning equipment, product substitution, and similar fraudulent acts that have been exposed in this testimony.

To say the least, it documents a story of greed, malfeasance and other fraudulent schemes that bilk the American taxpayers of billions of dollars and at the same time diminish our citizen's confidence in the executive branch's ability to efficiently administer essential governmental functions.

It was our feeling in the House that these investigations were not merely history lessons, but were a collection of facts that describe a relatively small, but extremely malignant blight on our society which is a continuing problem. Unfortunately, recent revelations indicate that we have not underestimated the seriousness of the problem.

While all of the details are not yet available, it appears that the current scandal within the defense industry may be the worst in the Pentagon's history. Among other things, that suggests to me that our current Federal statutes are not providing a sufficient deterrent to discourage such practices and that there is not enough information readily available to law enforcement agencies in order for them to discover and prosecute these illegal acts.

Even before the recent allegations surfaced, we in the House believed there was sufficient basis to justify H.R. 3911. For example, the GAO released a report in January of 1988 in which it estimated a loss due to procurement fraud of $387 million in but 148 open procurement cases reported to the Secretary of Defense from April 1, 1985, through March 31, 1986.

This report also noted that in fiscal year 1986 there were some 1,919 new fraud investigations as compared with fiscal year 1983, when there were 870 such investigations.

This GAO study, by the way, included only 32 product substitution cases which are a priority for DOD. In the product substitution area alone, cases where contractors deliberately provide inferior products on DOD contracts which can directly cost Americans their lives, investigations have increased to the point where there have been 85 indictments since January 1986.

As of October of 1987, the defense criminal investigative service was actively involved in another 231 product substitution cases. H.R. 3911 is fashioned to meet these problems, and to create new deterrents to criminal fraud.

It creates a new free-standing procurement fraud offense regarding contracts of $1 million or more, and is patterned after the Bank Fraud Act.

Under current conditions the bill would cover some 9,900 prime contracts. I know that the committee knows that we really don't have a free-standing fraud statute as such in the law at the present time. U.S. Attorneys have to use mail fraud, wire fraud, and the false statement provisions of title 18 U.S.C.

This bill would create a free-standing procurement fraud statute.

The maximum prison sentence that could be imposed under H.R. 3911 is 10 years. This is consistent with the maximum in comparable legislation.

The bill provides for a mandatory minimum sentence of 2 years if the offense involves foreseeable and substantial risk of personal injury. This is to cover those egregious situations, usually in product substitution cases, where a contractor provides such items as defective parachute cords; faulty jet ejection seat valves; or defective nozzles for fire-fighting equipment on ships.

These provisions should act as an additional deterrent to such life-threatening conduct.

The bill contains an alternate fine of up to $10 million, which should be a new deterrent to corporate fraud. It also would provide an extension to the statute of limitations in which prosecutions could be initiated to up to 7 years, rather than the normal 5 years, to accommodate the extensive investigations often required in this type of fraud.

In addition, the bill establishes a new system of rewards under which up to $250,000 can be paid from the criminal fine to individ-

uals who provide information leading to a conviction, as well as protection for whistle blowers, similar to provisions included in the false claims acts amendments of 1986.

The bill does set limitations on who can receive these rewards and it requires the DOJ to recommend and the court to approve such a reward. Those ineligible for rewards are as follows:

(1) Government employees performing their official duties.

(2) Workers who could have come forward with information to an employer at the formative stage of an offense, and could have prevented it or stopped it from occurring.

(3) And third, individuals who participate in the offense.

I believe that the Major Fraud Act of 1988 could become not only a major tool to fight procurement fraud, but an incentive for responsible individuals to come forward with information needed for the prosecution of major frauds against the government.

This latter aspect of the bill will be an additional deterrent to further illegal acts. I am very pleased that the Senate Judiciary Committee has moved so very quickly to consider the Major Fraud Act of 1988.

I look forward to working with you to secure its enactment into law this year.

I might say to this distinguished committee that this bill is not the final word in this area. We do have a major resource shortfall and as Senator Proxmire has so aptly stated, although the Justice Department has made procurement fraud and white collar crime a priority, ou own subcommittee on crime, through the hearing process, has determined that that's a priority in name only, because we have not committed the resources.

We don't have the FBI resources, the investigative resources, to do the job that needs to be done and we don't have sufficient U.S. attorneys to pursue these crimes, or for that matter, many other areas of crime. We just haven't provided the resources in the U.S. attorneys' offices that is needed.

We just haven't made the kind of commitment that's needed. We also have a constant turnover of expertise and that undercuts our enforcement effort.

No sooner does an assistant U.S. attorney become conversant with a particular case, than he moves on to the private sector at a much bigger salary, and of course, we lose that expertise.

So we need to shore up the criminal justice system all along the line. But I would submit that this legislation would provide, I think, a new tool, an effective tool, that could certainly assist our law enforcement community.

The committee should consider one technical adjustment that might be made to H.R. 3911. It is possible to interpret sec. 1031(b) of the bill to allow a judge to only fine a defendant even if the offense involves a foreseeable and substantial risk of personal injury. Any sentence under those conditions would have to be a mandatory minimum of 2 years, but in reading sec. 1031(a) in conjunction with sec. 1030(b), the bill, as presently constituted, may not require any incarceration.

In order to clarify this matter, I would suggest that the Senate add in the first sentence of new section 1030(b) added to title 18 by the bill—

(1) Strike out "the term of imprisonment" and insert in lieu thereof "a term of imprisonment shall be"; and

(2) After "Subsection (a) of this Section" insert "and such term".

Another question has been raised as to whether the $10,000,000 cap imposed in new section 1031(b) would limit a fine imposed under 18 U.S.C. sec. 3571(d) which allows a fine equal to twice the gross gain or twice the gross loss. Since, however, the $10,000,000 cap is applied to those fines that ". . . may exceed the maximum otherwise provided by law", it is my reading of this bill that the $10,000,000 cap would not apply to a fine imposed under 18 U.S.C. sec. 3571(d).

I thank you.

Senator DECONCINI [presiding]. Thank you very much. Let me ask you one question that troubles me about both your legislation, S. 1958, and H.R. 3911. I don't see any penalty in it where the court could void a contract, or prohibit the contractor from participating for a period of time as part of the sentence.

I'm assuming that the contractor is found guilty. Did you pursue that, Representative Hughes, in your hearing, and if so, why did you rule that out?

Mr. HUGHES. Yes, we had some sentiment within the committee to deal with the debarment issue but that doesn't fall within our committee's jurisdiction.

As you know, we are very fragmented with jurisdiction. And frankly, we could not——

Senator DECONCINI. You mean that penalty wouldn't fall within the jurisdiction, as part of the penalty, assuming that guilt is proven and a verdict is rendered?

Mr. HUGHES. We would not have jurisdiction over debarment provisions.

Senator DECONCINI. How about you, Senator Proxmire? Do you have any thoughts on that subject matter?

Senator PROXMIRE. I think it's an excellent point. But I don't have any specific recommendations on it.

It seems to me that would make a good amendment to the Hughes bill. It is a superb bill. It is a great advance. But I think that what you suggest is something that the Senate might add.

Senator DECONCINI. It just seems to me the penalties apparently are not working, the million dollar penalties and what have you, and we are talking about increasing that substantially.

But it seems to me that if the contractor could face a disbarment and noncontractual basis, that that would be a great incentive.

Senator PROXMIRE. The difficulty, of course, is that we can apply none of the present penalties at all. Because all the cases seem to evaporate with time and delay.

And as both Congressman Hughes and I have pointed out, with the turnover of staff and the lack of resources.

Senator DECONCINI. Then coming to that question, Congressman Hughes, you mention a lot more needs to be done in addition to this legislation. I presume your position is, we'd be better off to pass this bit, even though it's not all of it. But don't we need to do something about career prosecutors in the Justice Department and investigators that are going to be able to be enticed to stay there for a period of time, more than 2 or 3 years?

Mr. HUGHES. I favor reviewing and increasing salaries to make them more attractive. I have always felt that it was important for us to develop certain commitments in exchange for employment; to retain that expertise for a period of time.

We need to do all those things. And I also favor the kind of targeting that is in the Proxmire bill, or Proxmire-Grassley bill, that would in fact develop expertise so that we can, on a regional basis, move a mobile team around the country.

Since we don't have resources to place them in every jurisdiction, it would be important to have a task force operation that we can move around the country to deal with these problems.

But your suggestion about debarment is a good one. Frankly, if we had had jurisdiction, I have no doubt we would have had provisions in here that would have dealt with the debarment issue.

Senator DECONCINI. Have either one of you worked on any language on disbarment over your experience?

Mr. HUGHES. No.

Senator DECONCINI. Thank you, Mr. Chairman.

Senator METZENBAUM [presiding]. One last question along that line about debarment.

I remember the Navy not too long ago that had debarred a general contractor and then withdrew the debarment because they said they didn't have anybody else to make the ships for them; there were no other places to go.

What do we do about that? I don't like that solution; in fact, I'm embarrassed by it for our own government. But what's the practical answer to that?

Senator PROXMIRE. As I understand it, the practical answer is that debarment is a Defense Department function. It has been, and it's up to them to do it. And I think we ought to do everything we can to provide, if necessary, legislation to encourage them to do it; require them to do it.

Senator METZENBAUM. Well, my point is that the Navy said that we need the ships, and there are no other shipyards that can make the ships.

Mr. HUGHES. I think the answer, Mr. Chairman, the answer is to diversify our procurement base. Unfortunately, we are hostage often to one particular source and unfortunately, that does in fact work against debarment.

The Department of Defense has no trouble debarring little contractors where they're not essential. It's when we get into the large sole-source providers that we have major problems.

The long term solution is to diversify that base so that we have more competition that we have today.

Senator PROXMIRE. Admiral Rickover had a tough proposal that's very hard for us to accept, but it made some sense. Where you do have only a single source, or an inadequate single source, he suggested that you use the government arsenal.

The government itself should step in. People say, oh, that's socialism. Well, if you have to have that kind of performance, competition, quality, that you're not getting, that's something that you ought to consider.

Senator DECONCINI [presiding].

Senator GRASSLEY. Thank you very much.

I don't know whether anyone has thought about it or not, but here you are, a famous budget cutter, proposing we spend more money on a government program, maybe for the first time in your career.

Does it trouble you any to break with this tradition?

Senator PROXMIRE. Well Senator Grassley, I'm delighted you asked that, because that's right, I'm against spending money on anything.

I have tried to personify the great example of Ebenezer Scrooge. I think that's what we need in government.

However, in this case, it's a great way to reduce the deficit. You spent $8 or $9 million on what you and I are proposing, and there is no question in my mind it will bring in far, far more every year; no question. And it'll bring in fines and so forth, and also, in far better performance and lower cost.

So it is an excellent investment if you enforce the procurement law and prevent the kind of corruption which undoubtedly is increasing the cost of this, what is it, $300 billion a year that we're spending on defense procurement.

Senator GRASSLEY. I believe you were involved in the creation of the Foreign Corrupt Practices Act.

And as everybody knows, that act makes it illegal for U.S. companies to bribe foreign officials. What connections or insights do you see between the overseas bribery cases of the 1970s, and the current defense procurement investigation cases?

Senator PROXMIRE. I think there is a direct and explicit connection. The bribery there also involved defense contractors and weapons. It was the Lockheed Corporation that wanted to sell planes to Japan that paid a $1.4 million bribe to the Prime Minister of Japan.

He was convicted. He went to jail. For Lockheed, the bribe was great business. They made tens of millions of dollars of profits out of it.

Now, think of that for a minute. A $1.4 million bribe to the top elected official. It would be like the President of the United States accepting a million dollar bribe. A horrible shocking shame, for this country as well as Japan.

I am glad you raised that point, Senator Grassley, because I want to tell you something. The trade bill includes in it, unfortunately, a gutting of that Foreign Corrupt Practices Act that we passed in 1977.

If a trade bill passes in its present form, if we fail to amend it on the floor, it's going to mean that the one legislation that we have that has done an excellent job of preventing bribery, of stopping those scandals, is going to be gutted, repealed, and we're going to be once again shamed with enormous bribes that will be paid, because as I say, it is good business.

And incidentally, a study of that 1977 law showed that it did not inhibit exports. As a matter of fact, exports increased in 1978 and 1979, and the two following years are the best time to determine the effect of the law.

So that here is a law that the corporation executives of this country, to their discredit, have successfully lobbied into accepting. They inserted into a 1000-page bill a few lines that gut the law.

And we are going backwards rather than forwards in this area. And I hope that when the trade bill comes up before the Senate we can knock that language out.

Senator GRASSLEY. Congressman Hughes, I also compliment you for your leadership and involvement in this area. I have admired your commitment against waste and fraud since my service with you in the house.

If I could refer to some discussion of your bill that took place before the House Judiciary Committee, Rep. Hurtle recited over 10,451 allegations of waste, fraud and abuse in the Federal Government over a 6-year period, 55 percent of that related to Defense Department activity.

It seems to me to be disproportionate that just under 30 percent of our Federal budget is authorized for defense needs, and yet 55 percent of these cases relate to the Defense Department.

Do you believe that this apparent disproportion is due to the volume of activities that are involved in the defense of the nation?

Mr. HUGHES. I do not think there is any question. It is because of the volume involved, and often it is because of the pace that we were moving contracts out of the system, in the last 7 years in particular. We have put out billions and billions of dollars a day.

In fact, I remember debating just 4 or 5 years ago, amendments on the floor, that would permit a bypassing of the competitive bidding system because we weren't getting the money out fast enough.

Senator GRASSLEY. Do you believe that because of the turnover in those agencies charged with investigation and prosecution of fraud, waste and mismanagement in the government, such as U.S. Attorneys, there is a resource problem that must be cured before any meaningful oversight can be sustained?

Mr. HUGHES. I don't think there is any question that we have a serious problem of turnover within the Justice Department. It is not just in the procurement fraud area, but it is across the board. It has been a serious problem for a number of years, and we have not begun to deal with it.

Senator GRASSLEY. Your bill is very timely. I hope it will really turn the tide, not only in the short-term, but in the long run.

Mr. HUGHES. Well, you are kind to say that. You are one of the public officials, however, who have led the fight for a number of years in focusing attention on procurement fraud. And you are the one to be congratulated for your work and the work of your committee.

Senator METZENBAUM. Thank you very much, Senator Grassley. Thank you, Congressman Hughes, Senator Proxmire.

The Chair himself somewhat embarrassed that my staff, in their enthusiasm to permit everyone to be heard, has scheduled three separate panels.

The first three witnesses will come to the table, please. June Gibbs Brown, Inspector General, Department of Defense, accompanied by Derek Vander Schaaf, Deputy Inspector General; Victoria Toensing, Deputy Assistant Attorney General, Department of Justice, Criminal Division; accompanied by Anton R. Valukas, U.S. Attorney, Northern District of Illinois and Washington, D.C. both, I guess; and Richard Fogel, Assistant Comptroller General from the GAO.

The reason I am embarrassed is that we have that panel and we then have a panel from the U.S. Chamber of Commerce, electronic industries association, and aerospace industries; and then we have a fourth panel which has four additional witnesses.

It is 10:30. I had said that the government witnesses would have 10 minutes. I'd be grateful if you could do it in about seven. And it won't solve all my problems. But somehow I am going to try to move so that everybody has—so that we have a fair hearing out of this, and that nobody feels they have been prejudiced.

June Gibbs Brown, please proceed.

STATEMENT OF A PANEL CONSISTING OF JUNE GIBBS BROWN, INSPECTOR GENERAL, DEPARTMENT OF DEFENSE, ACCOMPANIED BY DEREK VANDER SCHAAF, DEPUTY INSPECTOR GENERAL, DEPARTMENT OF DEFENSE, WASHINGTON, DC; VICTORIA TOENSING, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE, ACCOMPANIED BY ANTON R. VALUKAS, U.S. ATTORNEY, NORTHERN DISTRICT OF ILLINOIS AND WASHINGTON, DC; AND RICHARD L. FOGEL, ASSISTANT COMPTROLLER GENERAL, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, DC

Ms. BROWN. Thank you, Mr. Chairman.

My written statement addresses our comments on the Major Fraud Act of 1988, and the role of the Office of Inspector General, Department of Defense, in the investigation and prosecution of major fraud cases.

Senator METZENBAUM. Want to bring the mike a little closer, please?

Ms. BROWN. We enthusiastically support the bill, and have prepared a few comments on some minor revisions that have been addressed by the House. I have included those comments in my statement.

I have also included a description of numerous cases that have been investigated by my office, that may be important to consider in your deliberations on this bill.

I would also like to point out the attachments to my statement, which show some of the progress we have made in our enforcement of the laws, as they currently stand.

We've had very significant increases in monetary recoveries, and I have a graph to demonstrate that point. The first half of 1988 has witnessed a 50 percent increase over last year's total monetary recoveries. Those have been gained with the cooperation of the Department of Justice.

We also have a graph that shows the increase in suspensions and debarments by the Department of Defense since the Inspector General Act was created.

In 1981 there were a total of 80 suspensions and debarments. In the last 2 years, we have had almost 900 per year. This year we have had 467 already in the first half. So this is a very useful tool that Defense is using when some kind of contractor irresponsibility is identified.

There has also been a significant increase in the number of fraud trained investigators in the Department of Defense. I have included a graph which points that out.

I am not saying, of course, that we don't need more resources, and that we could not do a better job if we had them. But I would like to recognize the significant progress that has been made.

I would like to submit my full statement for the record, and I am certainly available for questions.

[The prepared statement of Ms. Brown follows:]

HOLD FOR RELEASE
UNTIL DELIVERY
EXPECTED 9:30 A.M.
JULY 12, 1988

STATEMENT OF

THE HONORABLE JUNE GIBBS BROWN

INSPECTOR GENERAL

DEPARTMENT OF DEFENSE

BEFORE THE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

ON THE MAJOR FRAUD ACT OF 1988

JULY 12, 1988

It is a particular pleasure to be here today to testify regarding H.R. 3911, "The Major Fraud Act of 1988," and the role of the Office of Inspector General, Department of Defense, in the investigation and prosecution of major fraud cases. My Deputy, Derek Vander Schaaf, shared these views with the House Subcommittee on Crime during their consideration of the Major Fraud Act and I am pleased to bring them to the Senate.

THE MAJOR FRAUD ACT OF 1988

We support the bill as passed by the House of Representatives. The amendments made by the House Committee will prove to be helpful in clarifying the purpose, intent and application of this legislation. We particularly like the language in the bill which extends the statute of limitations to seven years after the offense is committed. This is appropriate in light of the practical constraints on the Defense Contract Audit Agency auditors, who often cannot even commence incurred cost type audits until months or often years after the submission of contractor claims for payment. Once commenced these audits often take months to complete. It is from these incurred costs audits that the Defense Contract Audit Agency sometimes identifies indications of fraudulent accounting practices on the part of contractors. In such cases, it is not unusual, because of the unavoidable delays in scheduling the audits, for criminal investigators to first receive the allegations

well into the current five year statute of limitations. Given the complexity of accounting issues involved, the criminal investigations of these audit referrals often may require many months or years to complete. The consequence of this series of events is that it is not uncommon for our investigations to run to a point where the current five year statute of limitations becomes a pressure factor in the ultimate prosecutive decision-making process. Alleviation of this pressure through extension of the statute of limitations to seven years is a revision of current law which we therefore enthusiastically support. An extension of the criminal statute of limitations would further the efforts begun by Congress last year when the statute of limitations in the Civil False Claims Act was extended.

Another provision which the Office of the Inspector General endorses is the reward provision which permits payment of up to $250,000 to any individual who furnished information leading to conviction under the provisions of this legislation. This mechanism, as contrasted to the qui tam provisions of the Civil False Claims Act, provides for a more direct means of rewarding true whistleblowers whose information leads to a conviction under this section. We do believe, however, that requiring a whistleblower to first report his allegations to his employer--who may be the ultimate defendant in a resulting Government action--can only act to deter the sort of good citizen involvement the Bill is supposedly designed to encourage. We certainly hope that most

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contractor employees are able to raise concerns about questionable business practices to their employers. But we also understand the real world. While we support self-policing by industry, we should also encourage Government contractor employee's to report suspected fraud directly to the Government when they fear retribution by company officials or have concerns over the company's willingness to take appropriate action. In addition, further clarification is needed regarding the rights of Government employees to obtain a reward under the Act. We believe that Government employees, whose official duties are in no way involved with the audit and investigation of the fraud, or with the program which is the subject of the fraud, should not be automatically precluded in sharing in the reward. The Attorney General should be provided sufficient flexibility to determine eligibility through implementing regulations.

Another important provision of H.R. 3911, which we strongly endorse, is the mandatory mandatory minimum incarceration of two years for defendants convicted for product substitution when the offense involved a forseeable and substantial risk of personal injury. Historically, punishments for crimes of this kind against the Department of Defense have not been appropriate to the egregious nature of such crimes.

I would like to point out an additional concern regarding maximum fines under existing law. As you are aware, with the

November 1987 implementation of the Federal Sentencing Guidelines, there is an element of uncertainty regarding the maximum allowable fine for violation of Title 18 of the United States Code. While Congress moved swiftly to rectify this problem, I am concerned that one element of existing law may have been unintentionally nullified. Under Section 931(a) of the Department of Defense Authorization Act of 1986 (Public Law 99-145), Congress increased the criminal penalty for a violation of the False Claim Act (18 U.S.C. 287) on Department of Defense contracts to a maximum fine of $1 million. This provision has never been codified. Our discussions with the staffs of Congress, the Department of Justice, and the Sentencing Commission have resulted in a concern that both the Federal Sentencing Guidelines and subsequent clarifying legislation may have overlooked this provision. Therefore, its current status is open to question. We are strongly in favor of the $1 million maximum penalty per claim for false claims on Department of Defense contracts, particularly as it applies to claims by corporations. I urge this Committee to provide clearer guidance in this area.

We are also concerned that the Bill should not require proof of a specific intent to defraud in order to obtain a conviction. Currently, most fraud cases are prosecuted under the False Statements Act (18 U.S.C. 1001) and the False Claims Act (18 U.S.C. 286, 287). The majority of courts have held that these statutes penalize the provision of false, fictitious or

fraudulent claims and statements. If the indictment only alleges that false or fictitious, and not fraudulent, information was knowingly submitted to the Government, then the Government is not required to show a specific intent to defraud. Specific intent is often impossible to provide. The House Report on this Bill contemplates that "knowing" include deliberate ignorance or "willful blindness" of the facts which form the basis of the fraud. We concur and would further include the concept of "reckless disregard." Thus, the Bill should clearly state that specific intent need not be proven in order to establish liability under the Act. The House Report on the Bill clearly states that specific intent is not required. Such an interpretation from the U.S. Senate would be consistent with the amendments which were passed by Congress last year which clarified that specific intent need not be proven in order to establish liability under the Civil False Claims Act, and the Program Fraud Civil Remedies Act.

THE ROLE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE IN PROCUREMENT FRAUD

Over the past few years, Congress has clearly been responsive in providing the executive branch with more tools and remedies to combat fraud. The best example of such congressional initiatives was the passage of the Inspector General Act of 1978, and the Department of Defense amendments thereto in 1982. The DoD was

not included among the agencies covered by that original IG legislation. Rather, the Secretary of Defense was asked to staff a study group to determine how best to attack fraud and waste in the Department. The group concluded that a senior official, reporting directly to the Secretary, was required to coordinate the overall effort to achieve economy and efficiency in Defense programs. Secretary Weinberger followed that recommendation in April 1981 by creating the position of Assistant to the Secretary of Defense (Review and Oversight).

Because, in large part, of the success of the Review and Oversight Office, and the perceived need by the Congress to arm that organization with full investigative tools. The Fiscal Year 1983 Defense Authorization bill contained language which created a statutory Inspector General for the Department of Defense and consolidated under that official the Defense Audit Service, the Defense Criminal Investigative Service, the Inspector General for the Defense Logistics Agency, and the audit policy function formerly held by the Office of the Comptroller. The new Inspector General further created an office for Audit Followup and one for Criminal Investigations Policy and Oversight, the latter of which issues investiga.ive policy applicable to all criminal investigative organizations within the DoD and generally oversees the Department's effectiveness in conducting fraud investigations. Special emphasis has been placed on ensuring the effective coordination of all available criminal, civil and

administrative remedies for fraud, and in coordinating voluntary disclosures of fraud by Defense contractors.

As the Inspector General function grew in DoD, so did its paybacks. While the organization has doubled in size since 1982 to meet the increasing challenges of watching over tax dollars entrusted to the Department, the monetary benefits and cost avoidance identified by the Inspector General auditors alone have averaged 25 times the cost of supporting the entire Department of Defense Inspector General organization.

We have also built an impressive record in pursuit of criminal allegations against those who seek to defraud the DoD.

In partnership with the Department of Justice, we have aggressively pursued prosecutions of procurement fraud and corruption. Our top priorities are offenses involving product substitution, mischarging of costs, and fraudulent defective pricing, as well as schemes which undermine the foundation of our integrity based system of contracting, such as bribery, kickbacks, and antitrust matters.

From Fiscal Year 1984 through Fiscal Year 1987, the Defense criminal investigative organizations (DCIOs) have had a major impact on contract fraud. The DCIOs are the four criminal investigative organizations within the DoD that are responsible

for contract fraud investigations: the Army Criminal Investigation Command, the Naval Security and Investigative Command, the Air Force Office of Special Investigations, and the Defense Criminal Investigative Service, which is the criminal investigative arm of my office. Together, these offices are responsible for over 1,250 convictions and the return of over $400 million to the United States Treasury in criminal fines, civil fraud judgments, and other forms of recoveries. Attached to my statement is a chart which shows the rise in criminal fines, restitutions, and other recoveries such as False Claims Act judgments.

I should also note that in order to achieve these results, my office has encouraged each of the Defense investigative organizations to increase the number of agents who are dedicated to fraud investigations. Another chart attached to my statement shows that in Fiscal Year 1982, the Department of Defense fraud agent strength was 375. As of the end of Fiscal Year 1987, that number had risen to almost 1,000.

Product Substitution. Our number one priority has been, and will continue to be, product substitution. Product substitution is when a contractor deliberately provides an inferior product on a DoD contract. It is that offense which can most directly cost service members their lives. Substandard, defective, or counterfeit goods in our weapons systems have no

place on the battlefield and can only lead to horrendous consequences.

Since January 1986, the Defense Criminal Investigative Service has obtained indictments against more than 100 individuals and contractors who were found to be involved in product substitution schemes. Currently, the Defense Criminal Investigative Service is carrying over 225 open product substitution investigations. Let me provide you with some representative samples of our most successful product substitution cases:

Spring Works, Incorporated - This company deliberately provided defecti springs which were ultimately installed in critical assemblies of the CH-47 helicopters, the Cruise Missile, as well as the F-18 and B-1 aircraft. The company falsified testing and inspection certificates. Two corporate officials were convicted, fined, and imprisoned.

Diversified American Defense - This company had a scheme to provide defective fins to be installed on 60 millimeter mortar rounds. The defective fins caused the mortar rounds to veer off target. The vice president of the company ordered company employees to pack and ship defective parts, then falsified testing documents to show that the fins were in compliance with the contract. The company and the vice president were convicted. The vice president was imprisoned

for one year, and the vice president and the company were fined over $900,000.

MKB Manufacturing - This company deliberately provided defective gas pistons which were to be installed in the M60 machine gun. Once installed, the defective part would cause the machine gun to jam. One corporate officer was sentenced to serve 18 months, while another was sentenced to provide a few hundred hours of community service.

Waltham Screw Company - This company engaged in a pattern of deliberately providing defective flash suppressors for the M16 rifle. A corporate officer, when informed of the damage which could be caused by a defective rifle, stated that if one soldier was killed, there would be more around to complete the job. This official and the company were convicted. The company was fined $125,000, and the official was given a year in jail.

As you can see, while these criminal schemes are often life threatening and can have a disastrous effect on the ability of our troops to complete their mission, we have not received a significant sentence on most of these cases. A recently completed study by my office concluded that more information must be provided to the court at time of sentence which will identify the adverse safety and mission impact of product substitution schemes. My

office and the Department of Justice are working on procedures to implement this recommendation. Furthermore, based on our recommendation, the recently enacted sentencing guidelines provide for an increased criminal sentence for product substitution cases.

Cost Mischarging/Defective Pricing. As representatives of my office have testified before the Senate Armed Services Committee and elsewhere, the investigation of cost mischarging and defective pricing by contractors is a top priority of our agents. Those cases represent two of the most common and serious abuses found in public contracts. They are also among the most complex investigations, with a myriad of cost allocation systems and procedures to be untangled, and the need for expert audit assistance. Not only do those schemes undermine our procurement process, but the impact is always greater than the actual dollars lost to misallocation or overpricing. For example, when direct labor costs are intentionally overcharged, so are the associated overhead and administrative expenses. Since those costs often exceed 100 percent of the labor costs, such mischarging ultimately results in greater than double the loss to the Government.

Let me share with you some of the mischarging and defective pricing cases which we have completed:

Cost Mischarging:

TRW - An investigation conducted by the Defense Criminal Investigative Service and the Defense Contract Audit Agency concluded that TRW had mischarged cost overruns on fixed price contracts on to DoD cost type contracts. TRW pled guilty in September 1987 and has repaid over $12 million in fines and restitution.

AVCO - An investigation conducted by the Defense Criminal Investigative Service and the Defense Contract Audit Agency concluded that AVCO had improperly charged Independent Research and Development and Bid and Proposal costs on to DoD cost type contracts. In June 1987, AVCO pled guilty to criminal charges and agreed to pay over $6 million in fines and recoveries.

Rockwell International - An investigation conducted by the Defense Criminal Investigative Service and the Defense Contract Audit Agency concluded that Rockwell had engaged in cost mischarging on Air Force radio contracts. Rockwell pled guilty and repaid over $1.2 million in criminal fines and recoveries.

Defective Pricing:

JETS, Incorporated - An investigation conducted by the Army Criminal Investigation Command and the Small Business Administration Inspector General resulted in the racketeering conviction of the contractor who submitted false cost estimates on numerous DoD laundry contracts. The contractor and its officers were sentenced to repay over $12 million in criminal fines and forfeitures.

Hayes International - An investigation conducted by the Air Force of Special Investigations, the Naval Security and Investigative Command, and the Federal Bureau of Investigation resulted in the conviction of an aircraft maintenance contractor for a consistent pattern of deliberate overstatement of labor costs. The contractor repaid over $2 million in fines and civil penalties.

Litton Industries - A Defense Criminal Investigative Service and Army Criminal Investigative Command investigation proved that the Clifton Precision subsidiary of Litton Industries had repeatedly overpriced Army contracts. Litton officials would add a "chicken fat" factor on to legitimate costs in order

to overstate prices. Litton pled guilty and paid over $10 million in fines and recoveries.

Harris Corporation - An investigation by the Defense Criminal Investigative Service and the Federal Bureau of Investigation resulted in the conviction of the Harris Corporation for a pattern of submitting false cost estimates on Army and NASA contracts. Harris paid over $9 million in fines and restitutions.

I would like to particularly emphasize the fact that many of these investigations were prosecuted in the offices of the United States Attorneys in whose jurisdiction the offenses occurred. Our ability to work directly with local United States Attorneys is an important complement to our effective relationship with the Defense Procurement Fraud Unit at the Department of Justice in Washington, D.C.

Coordination of Remedies. As I mentioned earlier, a high priority of the Office of the Inspector General, through the Office of the Assistant Inspector General for Criminal Investigations Policy and Oversight, has been to ensure that all available civil, criminal, contractual, and administrative remedies are appropriately considered and used in each case.

We are very proud of our record in this regard. Early on, we recognized a number of areas where the Department clearly needed to enhance its procedures to effectively resolve issues involving fraud. One of those was suspension and debarment -the procedures whereby corrupt contractors can be barred from doing business with the Government.

In a report issued in 1984, the Inspector General concluded that more positive steps were required to improve the effectiveness of these tools. More information from criminal investigators was recognized as a vital element to enhance suspension and debarment activity. All three Services and the Defense Logistics Agency concurred, and the DoD record on suspension and debarments has subsequently improved.

Since 1982, the number of DoD suspension and debarment actions has increased by over tenfold. A chart attached to my statement demonstrates the dramatic rise in suspension and debarment actions over the last eight years.

While we believe that we have demonstrated success in many of our antifraud initiatives, we are constantly aware of the need to improve the framework of laws under which we seek to attack major procurement fraud. For this reason, we have supported legislation such as amendments to the Ethics in Government Act to tighten "the revolving door," the Program

Fraud Civil Remedies Act, the 1986 amendments to the False Claims Act and the proposed Major Fraud Act of 1988.

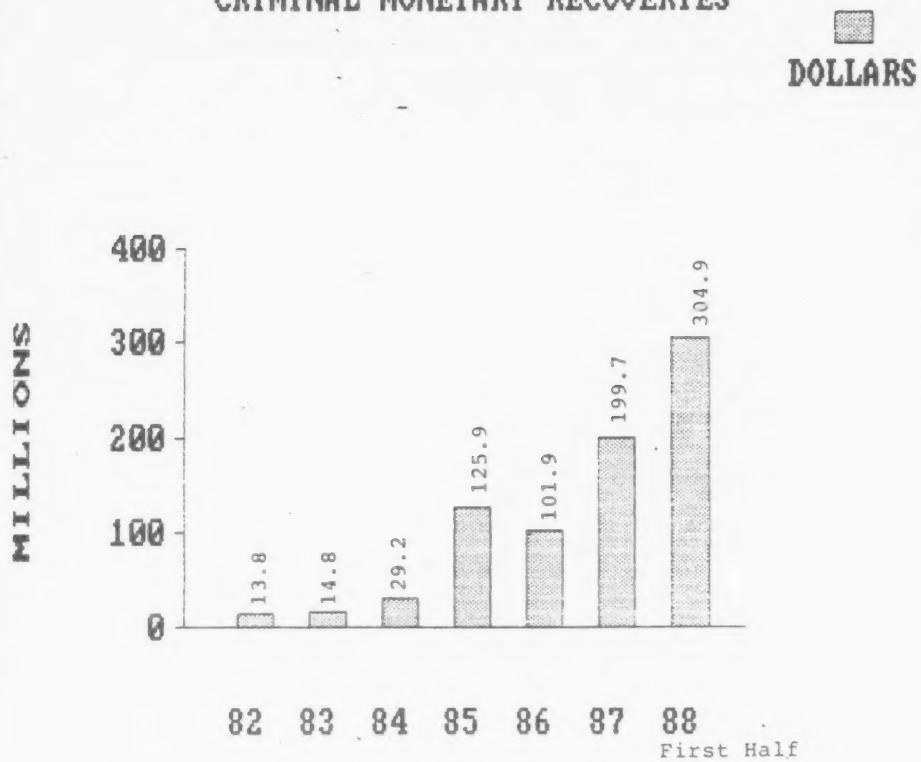
Mr. Chairman, that concludes my statement. I would be glad to answer any questions you may have.

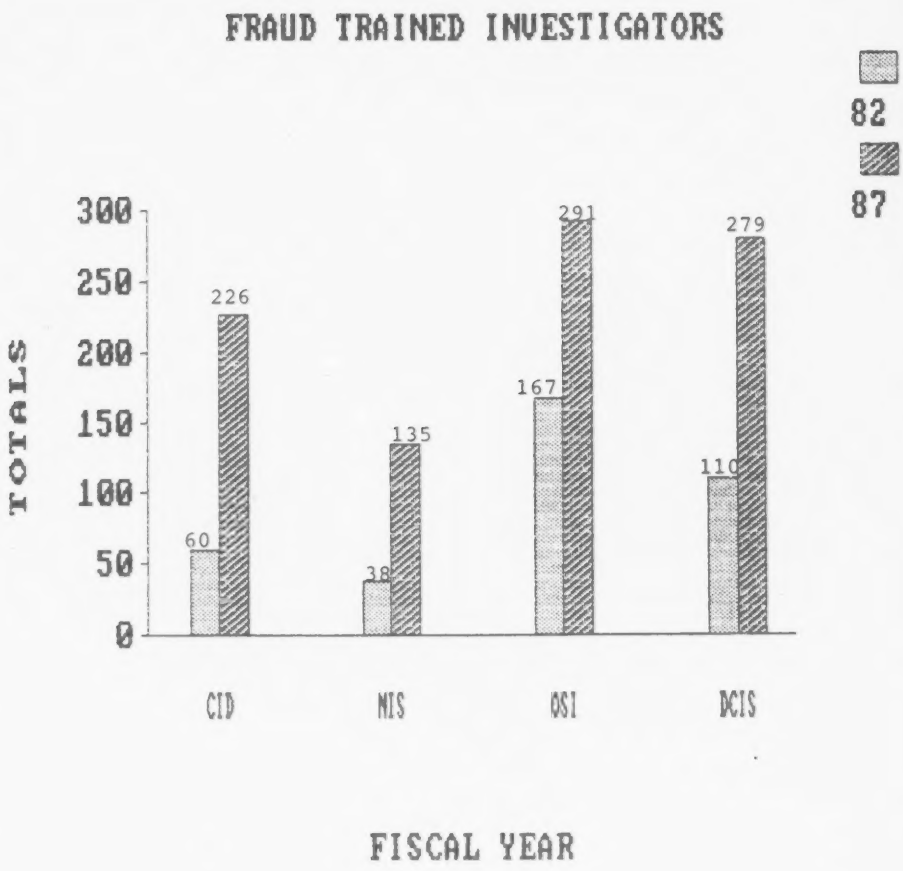
Increased Suspensions and Debarments

FY	Suspensions	Debarments	Totals
1981*			80
1984	134	268	402
1985	225	357	582
1986	470	415	885
1987	393	505	898
First Half 1988	173	284	457

*Data collected on a calendar year basis from 1981 through 1983.

CRIMINAL MONETARY RECOVERIES




FRAUD TRAINED INVESTIGATORS
82
87
TOTALS
300
250
200
150
100
50
0
226
60
135
38
291
167
279
110
CID
MIS
OSI
DCIS
FISCAL YEAR

Senator METZENBAUM. Without objection, all the statements of all of the witnesses today will be included in the record without further order.

I think I am going to inquire of the witnesses individually as they conclude their testimony. Let me ask you about some disturbing reports about former Pentagon officials convicted or suspected of criminal activity who later became defense contractors or consultants.

Mark C. Saunders, is a former Navy contracting official who was found guilty of making money in the stock market on the basis of insider information about a contract his staff had negotiated.

After his dismissal, Mr. Saunders became a defense industry consultant. According to Federal court papers, he is now being investigated for bribery in the current scandal.

Another case involves Richard D. Ramirez, a former Navy official who has been repeatedly accused in Federal court testimony of accepting bribes in connection with the Wedtech scandal.

After leaving the Navy, Mr. Ramirez acquired a firm that won a $14 million Navy contract. Despite the bribery allegation, he reportedly has been allowed to continue dealing with the Navy, and even had his security status raised from confidential to secret.

Those are only two reported cases of convicted or suspected Pentagon wrongdoers who it seems were free to leave and set up shop as Pentagon business persons. For all we know, there may be many others.

To me, I am frank to say to you, it is incredible that such individuals, rather than being disbarred or suspended, actually could turn around and do business with the Department.

I am not certain how that could be. I am not blaming you, Ms. Brown. But doesn't the Department disciplinary rules bar such employees from doing business with the Department for at least a specific period of time?

Mr. VANDER SCHAAF. I guess maybe it would be more appropriate if I tried to answer that for you, Mr. Chairman. I am the Deputy Inspector General and was on the job while some of the activities took place.

With respect to Mr. Saunders, I am not intimately familiar with the previous prosecution that apparently involved trading in a stock in which he had insider information. I do not want to make any excuses for the Department here, because that case should have resulted in a review of his security status and whether or not he could, in fact, retain a security clearance following a Federal conviction.

I do not know what happened in that particular case, or why it happened. I think it is very unfortunate. You have to remember though, after he left the Department of Defense, as far as I know, he did not have any direct consulting arrangements with the Department or contractual arrangements with the Department. He had a contract with other companies which did business with the Department of Defense.

Regarding Mr. Ramirez situation, I do not believe that he was ever charged with anything while he was an employee of the Department of the Defense, and therefore, there would have been no

reason for the Department of Defense to suspend or debar him prior to the time he left.

Now that is an open case, and I cannot comment any further on it at the present time.

Senator METZENBAUM. You would not think that it would call for some action on your department when he is accused in open Federal court of accepting bribes in connection with the Wedtech scandal, and you would not think that that was a sufficient cause to move in and determine what his relationship is with the department?

Mr. VANDER SCHAAF. We are doing that at the present time, Mr. Chairman. We are involved in investigating the Wedtech scandal. Therefore I cannot comment any further on that at this point with respect to Mr. Ramirez. It is an open investigation.

Senator METZENBAUM. Well, I have to say to you, Mr. Vander Schaaf and Ms. Brown, I think what concerns us is the precision and the dotting of every "i" and crossing of every "t" in aggressively moving in when you find people who have questionable relationships, questionable activities, who have—you make a distinction between being found guilty with respect to insider trading in the SEC and find no relationship to that as far as the Department of Defense is concerned.

Mr. VANDER SCHAAF. Oh, there is clearly a relationship. In Mr. Saunders' case, I do not know what happened. And I would say it has to be looked at again. I do not know why he continued to receive a security clearance under those circumstances.

Senator METZENBAUM. I think what the American people are saying is that you can give us a list of increased numbers of debarments, and yet every time they pick up their paper, they find that programs that they are concerned about are being cut back and defense contractors are ripping off the American Government.

Mr. VANDER SCHAAF. Ms. Brown will tell you, we are here to stop them, and we have been doing so. That is what the 900 suspensions and debarments annually are all about. They are a result of the process. That is what the great increase in the number of indictments and convictions mean. Great progress has been experienced each year since the creation of the Office of Inspector General. This is a matter of record.

The situation is not getting worse. From that aspect, the situation is getting better; if you judge success by convictions and indictments. I sometimes wish we would not have to go through the convictions and indictments phase, and that industry would help to police itself. Unfortunately it does not always happen.

Senator METZENBAUM. Does debarment mean that they are totally barred from further contracts? Or what does it mean? How do you define a debarment?

Ms. BROWN. When an individual or a company is debarred, it is usually for a period of 3 years, but that can vary. It is an evaluation of their present responsibility in doing business with the Government.

Senator METZENBAUM. What was that last thing? An evaluation of what?

Ms. BROWN. Their present responsibility. When the Department looks at a company to determine whether or not it should be de-

barred for a particular offense, we look at the way they operate, whether they had knowledge of an offense, or should have had knowledge, and whether or not they have controls in place and have followed them to identify this type of activity. If it is found that they do not have controls, and they have not made an attempt to put them in place, or that they looked the other way, for instance, when things were happening that should have tipped them off, then they are certainly subject to suspension or debarment.

Senator METZENBAUM. And how long would you say the average debarment is of these 898 in 1987?

Ms. BROWN. Well, the period is 1 to 3 years. I do not know exactly what the average period is. But for the most part——

Senator METZENBAUM. Would you tell me what major companies have been debarred, names that we would recognize as being defense contractors? Because that is a large number, 898, and yet I have not heard of any major companies being debarred. Are there any?

Mr. VANDER SCHAAF. I do not believe any major companies have been debarred for a long period of time. A dozen or so, or a half a dozen to a dozen have been suspended for periods of time. Various divisions have been suspended.

You asked the question, Mr. Chairman, early on, of Representative Hughes, why we do not suspend and debar the big companies. You got into the discussion that they are the sole providers of these resources.

Our office has historically pushed for suspension and debarment of the officials of those companies. I do not think you want to take it out on the workers by putting those companies out of business. Most employees generally have nothing to do with illegal activities and are not responsible. That shipbuilder laborer out there in the shipyard was not responsible for the fraud that took place, and I am not sure it is correct to put him out of business because one of his bosses further up the line defrauded the Government.

We ought to get his boss out of the business and get him out of the business permanently. We have strongly recommended that from time to time to the suspension and debarment officials of the Department of Defense.

Senator METZENBAUM. Mr. Vander Schaaf, you lost me.

You are now saying that we have not debarred any major companies, and you are saying we are not sure we ought to do that because it would result in hurt to the employees, maybe the community as well. And I understand that. Now, then, you also tell me that 898 debarments occurred in 1987, 505 in 1986, and 393 suspension.

Now, my question is: Are you saying that we only take the little guys and debar them and suspend them because not as many people are involved and that that is part of the evaluative decision? I am lost.

Mr. VANDER SCHAAF. Not at all, Mr. Chairman. We suspend and recommend suspension of big guys and little guys. Let's face it. There are 100,000 little companies doing business with the Department of Defense. You take the top 50 companies, and you have got probably 70 percent of the total procurement dollars spent in the Department of Defense. So, obviously, you are going to have far

more suspensions and debarments involving small companies than you will large companies.

Now, you also have to face the realities of the situation. Large companies have, if you will, advantages when it comes to a suspension or debarment situation because the Department of Defense is charged with providing for the defense of the United States. And if we stand to lose critical weapons systems for long periods of time, we have to take that into consideration. There is no way to avoid that problem.

That is why our office has historically said we have to get the corrupters out of the business.

Senator METZENBAUM. Mr. Vander Schaaf, I can understand what you are saying when you are telling me about a Navy yard. I cannot understand it when you are talking about some avionics, when you are talking about some electronic equipment, and I am really getting the message from you that: "Well, we are only picking on the little guys but we are not picking on the big ones because we cannot afford not to do business with them; besides, you put too many people out of work." And it leaves me with a negative feeling.

Mr. VANDER SCHAAF. Let me respond one more time. I will try to get my point across to you, Senator. I can only say, ask the big guys if you do not think we are picking on them. They know they are under investigation.

Senator METZENBAUM. Ask the average American if they think you are picking on the defense contractor. They think that it is a piece of cake to walk in and steal money.

Ms. BROWN. Mr. Chairman, we try very hard to see that these kinds of sanctions are imposed on the people responsible and the units responsible. It is not necessarily proper, aside from the fact that we need the resources of those companies, to debar an entire company if we can identify the elements within that company that have responsibility for the actions. We have not yet identified an entire large contractor, and I do not expect to, that has a general policy that would indicate some kind of improper or illegal activity with the Government.

I think that the American people have to be aware of the kinds of aggressive actions that are being taken. The current case is a good example of the various elements of the law enforcement community working together. The Department of Justice, U.S. Attorney's Office, the various elements of law enforcement, including the FBI, Naval Investigative Service, the DCAA auditors, as well as my own organization, the Defense Criminal Investigative Service—have all supported this investigation, and they are working very hard toward a successful conclusion and successful prosecutions of those people responsible. Although we are all appalled at the kind of activity that sometimes take place, and the offenses that people commit, we still have to recognize that proper actions are being taken. The Department is working to get these people out of the business.

Senator METZENBAUM. Senator Grassley.

Senator GRASSLEY. Mr. Chairman, just to follow up on your line of questioning, I am reminded of what a wise man once said. Laws are like cobwebs: They catch the little flies, but the hornets and

the wasps get through. That might explain the historical problem that I outlined in my opening statement.

What you describe is really a problem, and sometimes I think there is a big public relations game played by the big defense contractors. It is announced in the newspapers that so-and-so is suspended or debarred; and then down the line, 3, 4 months, maybe when there is another contract that has to come up for negotiation, you read about how the suspension or debarment is lifted. We really need to study that when there is a debarment or a suspension, how long-lasting that is.

I would like to ask either Ms. Brown or Mr. Vander Schaaf, am I not right that the DOD, IG agency has regional offices for its DCIS investigators?

Ms. BROWN. Yes, sir.

Senator GRASSLEY. Could you elaborate for me on why you have regional offices instead of centralized direction from the Pentagon?

Ms. BROWN. Well, the offenses take place throughout the United States, and sometimes outside of the United States. The investigative activity is such that it is very important for the people to be very close to the problem under investigation. They have to identify sources; they have to work with this very intensely day to day. Our people work with the local U.S. attorneys as well as the Defense Procurement Fraud Unit, and these successful prosecutions we are talking about are taking place because of that day-to-day relationship and the close coordination that takes place at the site where these crimes and offenses are occurring.

Senator GRASSLEY. Would it be fair to say that the regional concept of investigators and prosecutors is dedicated solely to combating major procurement fraud, and that it is potentially better than the current structure, particularly if more resources are devoted?

Ms. BROWN. Well, I am certainly in favor of more resources being devoted. I have not done any in-depth study of how those might best be applied, and I would like to defer to the Department of Justice.

Certainly, building up those U.S. Attorney Offices would be helpful as well.

Senator GRASSLEY. Would it be fair to say that the age-old problem of cooperation between investigators and prosecutors, particularly between DOD and DOJ, could stand to be improved, and that the regional fraud unit concept might help in that regard?

Ms. BROWN. I think that is always fair to say. We work very hard at improving those relationships, and in very active investigations such as those we are involved in, there is always room for misunderstandings or people hoping that others would do a little bit more. I am sure they feel that way about investigators, as we do about prosecutors.

However, the relationship is greatly improved, and, of course, this would have the potential for improving it even further.

Senator GRASSLEY. Your predecessor, Joe Sherick, in several congressional hearings, spoke of the difficulty he had with prosecutors, and that it was his job to push prosecutors to move his cases. In 1985, when he was before my committee, I quoted him speaking about prosecutors: "We send them letters, we call them up, we talk

to them, we do everything we can but stand on our heads because that is our job to try and get our cases handled."

Have you ever heard complaints from your investigators that cases that they have worked on have languished when they are referred to the Justice Department, and that they cannot learn from Justice whether they have been accepted or declined, and that these delays slow down the momentum of the investigations?

Ms. BROWN. I have heard investigators complain if the priorities are such that their case cannot be considered on the top of the heap. But I have heard much more praise. We have had numerous areas where we have worked together in a partnership. Sometimes we have had ongoing investigative activity that has taken place in conjunction with the U.S. Attorney's Offices, even for a period of years. The *DefCon* investigation in the Los Angeles area is a good example of where not only the U.S. Attorney's Office but my office, NASA, DCAA, and the IRS all participated. This investigation is still going on. Training was jointly given by our offices to U.S. attorneys in other parts of the country, and that same type of activity, which is parallel to the current case, is going on now in three other parts of the country and is under consideration for even more areas.

So I think that the situation that Joe Sherick addressed earlier has been tremendously improved. We have a very good record of successful prosecutions and increases in those prosecutive activities. And that certainly cannot be done by us in isolation.

Senator GRASSLEY. I am not so sure that it is the exception rather the rule, but from what I hear reported to me directly, I guess I would ask you to look a little more dispassionately at the operation. You might come to a different conclusion. But I will leave that for the entire record.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you.

Ms. BROWN. Sir, if I could just say, I have been in this job now for 8 months. I have looked at the previous record and looked at the conditions that exist now, and I think there is a contrast to what was being done before. There certainly is room for more improvement, and we will be working on that.

Senator METZENBAUM. Ms. Brown, let me conclude by first complimenting you on the story written about you, first for coming from my own community of Cleveland, and secondly, the excellent article about you in the February 14, 1988, Plain Dealer, which is very complimentary and indicates your strong record of achievement.

Having said that, let me tell you that one quote in there is a little disturbing. That is, " 'I would like to try to increase the comfort level between contractors and the Inspector General and the Department of Defense,' the native Clevelander said in an interview at her office." And I think that we in the Congress are so concerned about what has been taking place at the Department of Defense that we would like to ask you to change that to maybe make it into a discomfort level.

We think the contractors have been too comfortable at the Department of Defense, and the American people, as a consequence, are the uncomfortable ones. Let us reverse that, if we can.

Ms. BROWN. Thank you, sir. I would like to comment on that briefly, if I may.

Senator METZENBAUM. Yes, of course.

Ms. BROWN. It was not an exact quote, but basically, I have taken upon myself the responsibility to increase the communication and the ability of contractors and the Government to work together. The kind of fraudulent activity that has been identified, particularly recently, is something where there is no question about using an aggressive approach. We need to take whatever actions are within our power to see to it that it is permanently ended.

However, there are a vast number of people who are trying to do a good job and need to be able to communicate with the Department of Defense. We need to clearly communicate to them what kind of safeguards we expect them to have, and what they are expected to do, if they identify problems within their own organizations.

One of the statistics given in earlier testimony related to the DII, the Defense Industry Initiatives, to which 46 contractors have signed up. In earlier testimony that Derek and I have given, we were asked how many of the contractors are under investigation. The statement at that time was that we were not sure. It was estimated to be about 39. The correct number is 38. But I would also like to point out that 25 of those 38 contractors have made voluntary disclosures.

Now, in a few cases, there are also independent investigations, but of those 35, 25 contractors have made voluntary disclosures to the Department of Defense. This is not a cure-all; it is a small step in the right direction. We are getting information that was not available to us before, and we are trying to work in conjunction with contractors who are trying to obey the law and do a good job. I think such work has to be done.

Senator METZENBAUM. If they had not made the disclosures, those 25 out of the 35, would the Department of Defense have known enough to proceed against them?

Ms. BROWN. To be in the voluntary disclosure program, it has to be a matter that is unknown to the Government at the time of the disclosure. Now, I do not want to soft-pedal this. At many of those companies, we have ongoing investigations where, even if they disclosed it, the matter was known to us at the time and that is not entered into the program.

In addition, we have investigations going on of contractors who have never made a voluntary disclosure, and we wonder whether or not they are serious about the systems in place. But I do not think we can take the statistic which was given earlier and condemn industry for being under investigation.

Senator METZENBAUM. Thank you very much, Ms. Brown.

Ms. Victoria Toensing, Deputy Assistant Attorney General, Department of Justice, we are happy to have you with us again.

STATEMENT OF VICTORIA TOENSING, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE, ACCOMPANIED BY ANTON R. VALUKAS, U.S. ATTORNEY, NORTHERN DISTRICT OF ILLINOIS

Ms. TOENSING. Good morning, Mr. Chairman, and I would just like to reiterate that it is a pleasure working with the Department of Defense. June Brown and I, when some problem arises, we pick up the phone and we call each other and we meet. And we are working out any glitches that we see. So it has been a very enjoyable relationship. She and Mr. Vander Schaaf have been very responsive to our needs, and I hope we have been to theirs. We will continue to do that.

Thank you for asking the Justice Department views on H.R. 3911. I want to come right out front and say we wholeheartedly support this legislation. We welcome it. We have laws that we are working with that originated about 80 years; and while we have been able to fit most of our prosecutions into these very specific, older statutes, we welcome what we consider a fine new tool for going after a specific fraud.

There are really five significant provisions in this piece of legislation, and I would like to just go over each of the five very briefly to stay within your time limits.

The first is the creation of the general fraud crime in the procurement process. This idea is very similar to what we had in the bank fraud area several years ago when we came here asking for help in that area because we did not have a specific bank fraud crime. We were always having to find some kind of connected act, like a false statement, an 18 U.S.C. 1001. Since that bill was passed, that is now 18 U.S.C. 1344, that has become the statute of choice for our prosecutors in bank fraud cases. So we welcome this new piece of legislation. While we do not need it quite as drastically as we did the bank fraud, we certainly welcome that.

The penalties. You have opted to increase the penalties and the fines, and we certainly welcome that. Some judges have been good in the past years, and they have improved their sentences on white-collar criminals. But some have been very slow to give these kinds of criminals any kind of time whatsoever. But let me provide a caveat to you that the statute might not immediately provide all of us the longer sentences we seek in this area.

Offenses committed on or after November 1, 1987, will be subject to the sentencing guidelines, as we are all aware, unless the Supreme Court does otherwise. At this time, we cannot really predict what kind of outcome these guidelines are going to have. We are going to take a guideline for a first offender, which is usually the case in this kind of crime—you have first offenders most of the time. And if you have a first offender who organizes a group of five or more persons in a procurement fraud, costing the Government more than $5 million, he or she would receive 46 to 57 months under the guidelines. That is short of 5 years, which can very easily be figured out.

But we say go to it. Let us increase those sentences, because the Sentencing Commission will continue to reevaluate what their guidelines are. And so if they see that we in the executive branch

and you in Congress are pursuing higher sentences for these kinds of crimes, then maybe they will up some of their guidelines. So we have nothing to lose and everything to gain by endorsing this kind of legislation.

On the statute of limitations, again, we wholeheartedly support increasing the statute of limitations to 7 years. These cases are very complicated and require thousands of hours to analyze sometimes literally millions of documents. So we need this increase on the statute of limitations.

In legislation that we had given to this committee in 1987, we had recognized that problem, and we had asked for an increase in the statute of limitations in a more complicated kind of formula, which would have resulted in a maximum of 8 years. But this is a simpler, cleaner approach to it, and we like your approach better than ours. We like the flat 7 years, and we hope that that is included.

The rewards for the whistleblowers. Again, we support this. We think that that is a nice incentive to reward those persons for providing information which leads to a conviction, and it is similar to the drug enforcement legislation which we have also endorsed.

On the whistleblower protection, recently Congress has enacted two whistleblower protection statutes, one in the False Claims Act and the other in the National Defense Authorization Act of 1987. We in no way condone any retaliation against those persons who would cooperate with our efforts to investigate and prosecute procurement fraud. However, what we would like to see is for you to wait until we see how these two statutes work in the present system before we pass any more legislation. And let me point out a very important reason why.

Presently, this provision could conflict with DOD policy, which is that a corporation should punish those persons who are responsible for criminal activity. We have found that many times whistleblowers were also involved in the culpable activity. And so if we pass more and more of this legislation, we put the corporation between a rock and a hard place. We say to them: You have to punish somebody who was involved in criminal activity, and on the other hand, if you do so to this kind of person, there is protection. And we think that we really ought to evaluate how that system works with the present policy that anyone who is involved in criminal activity should be punished in some kind of way.

There are some other technical suggestions that I have made on Pages 10 and 11 of my testimony, and I will just let the record stand on that. We will be delighted to answer any questions if you have them. But I would like to make one more important point, and that is regarding the Anti-Fraud Enforcement Act of 1987 that we had submitted to this committee last year. It was in this legislation that we had made our request for the increased statute of limitations.

We very much need another provision in that proposal, one that would amend Rule 6 of the Federal Rules of Criminal Procedure; that is, the grand jury secrecy rule. Under the present grand jury secrecy requirements, we are severely limited in providing grand jury information to the Civil Division and to our sister agencies. If

I could just finish this one point, because I think you would want to know about this problem that we have, Mr. Chairman.

Therefore, we can be in the middle of a grand jury investigation, know about a contractor's problems, and not be able to tell the Defense Department, for example. That is a ludicrous rule for us to have to continue to comply with. Certainly, we will if it is the law. But if we really want to fight fraud, then we should be able to share with the Defense Department or whatever other agency information that we have during the course of a grand jury investigation. Presently, I am thinking of one that is going on where we see a pattern of problems, but we cannot share this with the agency that is involved.

I will be delighted to answer any questions.

[The prepared statement of Ms. Toensing follows:]

STATEMENT

OF

VICTORIA TOENSING

DEPUTY ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

BEFORE

THE

SENATE JUDICIARY COMMITTEE

CONCERNING

MAJOR FRAUD ACT, H.R. 3911

ON

JULY 12, 1988

Mr. Chairman and Members of the Committee:

I am pleased to have the opportunity to appear before you today to discuss the views of the Department of Justice on H.R. 3911, the "Major Fraud Act of 1988." We strongly support the thrust of this proposal because it would significantly enhance our ability to investigate, prosecute and punish large scale procurement fraud. We believe it would greatly facilitate our efforts in cases arising out of the operations of the Department of Defense, which, as you know, are cases which the Department of Justice has designated as a top priority.

The great majority of government fraud cases today are prosecuted as conspiracies to defraud the United States (18 U.S.C. 371), false statements (18 U.S.C. 1001) or false claims (18 U.S.C. 287). Each of these provisions originated in legislation passed in 1909, and each was recodified in substantially its present form in 1940. While procurement fraud affecting the United States usually falls within the prohibitions of one or more of these statutes, we believe the enactment of a comprehensive prohibition directed at major government fraud, such as that embodied in H.R. 3911, would further our prosecutive efforts very substantially.

Our strong support for the enactment of a comprehensive statute targeting a major species of fraud is based on our analogous experience with fraud affecting the nation's financial

institutions. Prior to 1984, the statutes used to prosecute bank fraud, principally 18 U.S.C. 656, 657, 1005, and 1006, were also dated, having their origins in legislation passed during the depression. No generic bank fraud statute existed. The great majority of cases of bank fraud we encountered were cognizable under these old statutes, but in some cases, prosecution was either very difficult or totally foreclosed.

In 1984, Congress responded to our need by enacting the general bank fraud statute, 18 U.S.C. 1344. The general bank fraud statute makes it an offense to execute or attempt to execute a scheme or artifice to defraud an insured financial institution or to obtain money or property under the custody or control of an insured financial institution. This broad prohibition, following principles well established under the mail and wire fraud statutes, 18 U.S.C. 1341 and 1343, has proven its utility far beyond original expectations. In fact, in less than four years since its passage, section 1344 has become the statute of choice for prosecuting all forms of bank fraud. The presence of the general criminal prohibition has facilitated and simplified the prosecution of hundreds of cases throughout the country. There is every reason to believe that enactment of a general procurement fraud provision such as that embodied in H.R. 3911 would have an equally positive effect. 1/

1/ In the same way, recent legislation, such as the False Claims
(Footnote Continued)

H.R. 3911, which follows the language of 18 U.S.C. 1344, would enhance existing law by creating a new section 1031 in title 18, United States Code, to provide that "whoever knowingly executes, or attempts to execute, any scheme or artifice (1) to defraud the United States; or (2) to obtain money or property from the United States by means of false or fraudulent pretenses, representations or promises; in any procurement of property or services for the Government, if the value of the contract for such property or services is $1,000,000 or more" shall be fined up to $10,000,000, imprisoned not more than ten years, or both. A term of two years imprisonment, apparently intended to be mandatory, is required if there is a foreseeable and substantial risk of personal injury. The bill further provides for a statute of limitations of seven years after the commission of such an offense. In addition, upon application by the Attorney General, the proposed legislation would allow payment to an individual who furnished information leading to conviction under this section. The payment would come from funds generated by a criminal fine imposed under the section; the amount of such payment would not exceed $250,000, and officers and employees of the government who furnish information or render service in the performance of official duties would be ineligible for such payment. Finally,

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(Footnote Continued)
Amendment Act of 1986, the Anti-Kickback Enforcement Act of 1986 and the Program Fraud Civil Penalties Act of 1986, reflects recognition by Congress that the civil and criminal penalties provided by earlier legislation were insufficient to address the current problem of fraud perpetrated against the United States.

the bill provides "whistleblower" protection for employees for lawful acts done to assist investigation and prosecution under this section.

In addition to creating a general procurement fraud offense, other significant enhancements to existing law are increased fines and imprisonment provided for major procurement cases, extension of the statute of limitations for such cases to seven years, authority to seek payments for persons who provide information which leads to conviction for procurement fraud violations and "whistleblower" protection. With the exception of the "whistleblower" provision, we support each of these objectives. With your permission, I would like to discuss each of these areas.

PENALTIES

We believe that there is no better deterrent to white collar crime than the imposition of lengthy jail sentences on white collar criminals convicted of serious offenses. When appropriate, we charge multiple counts in prosecutions founded on existing fraud statutes, such as the banking offenses (18 U.S.C. 215, 656, 657, 1005, 1006 and 1344), fraud against the government (18 U.S.C. 287 and 1001) or conspiracy (18 U.S.C. 371). Each of these offenses carries a potential sentence of five years imprisonment. By charging multiple counts, the sentencing court

is given the discretion to impose a sentence in excess of five years.

However, offenses committed on or after November 1, 1987 will be subject to the recently promulgated sentencing guidelines. Until we have acquired a body of experience under the guidelines, it is impossible to predict with any certainty the effect they will have. We note, however, that an initial reading of the guidelines would suggest that a first offender (the typical defendant in procurement cases) who organized a group of more than five persons which conducted a procurement fraud costing the government more than $5 million, would receive a guideline sentence of forty-six to fifty-seven months. This sentence would be within the statutory maximum permitted by existing law. Therefore, we doubt that an increase in the statutory term for procurement fraud would increase the sentences actually received by most defendants.

However, we support this increase because the Sentencing Commission will continue to evaluate the Guidelines. Enactment of H.R. 3911 would reaffirm the serious nature of major procurement fraud, and could cause the Commission to amend the Guidelines to increase the severity of punishment for such offenses.

With respect to fines, and notwithstanding the maximum fine of $10,000 set forth in several of the statutes commonly utilized

in procurement prosecutions, under the Sentencing Reform Act of 1984, now in effect, conviction under the statutes presently utilized in procurement prosecutions exposes the criminal to a maximum fine of $250,000 in the case of an individual defendant and $500,000 in the case of a corporate defendant. Existing law also provides for an alternative fine of double the gain realized by the defendant or double the loss caused by the offense. In many cases, such fine levels will be sufficient. Nevertheless, we recognize that there will be instances where larger fines will be appropriate in cases involving fraud against the United States.

Moreover, the Department of Defense Authorization Act of 1986 provides that "the maximum fine that may be imposed . . . for making or presenting any claim upon or against the United States, related to a contract with the Department of Defense, knowing such claim to be false, fictitious, or fraudulent, is $1,000,000." This provision is applicable to claims made on or after November 8, 1985. It makes penalties proportionate to the potential monetary gain for criminals, and should act as a serious deterrent to procurement fraud in the defense area. This fine provision, taken together with the recently enacted amendments to the False Claims Act which provide for a civil money penalty of three times the amount of the claim, acts as a substantial deterrent.

Thus, while fine levels are adequate in most cases, we suggest the Committee consider extending the defense procurement fine provision to all government procurement cases. In any event, it should be promptly codified to have its maximum deterrent effect.

In light of the foregoing considerations as to both the desirability of a comprehensive procurement fraud statute and the inter-relationships among the various sentencing statutes and guidelines, we believe that the Committee should consider enacting the general fraud provision of H.R. 3911 as a felony carrying a penalty of five years imprisonment or a fine under the provisions of title 18, and to apply the $1,000,000 contract provision as a trigger to invoke the enhanced penalty provisions contained in H.R. 3911.

STATUTE OF LIMITATIONS

We fully concur with the goal embodied in H.R. 3911 of enlarging the statute of limitations for prosecution of procurement fraud cases. These cases often require long and difficult investigations of very complex facts. Indeed, it is common for a defense procurement investigation to require thousands of hours to examine and analyze literally millions of documents. In addition, because concealment and secrecy are the hallmarks of financial crime, there is often a lapse of time before the cases come to our attention in the first instance.

Thus, defense procurement cases frequently are brought to indictment at or near the time the present five year statute of limitations expires.

In one class of cases, those involving defective pricing, the system virtually guarantees that the existing five year statute of limitations will present difficulties. Pursuant to the Truth in Negotiation Act, pricing data in these cases will be supplied to the government prior to the signing of the contract. After the contract is signed, a post-award audit is performed; the contractor is permitted to respond to the audit report, and the entire matter is reviewed again before a determination is made to refer the matter for criminal investigation. This process can take several years to complete. This systemic delay ensures that criminally fraudulent conduct occurring during the negotiation stage will not be discovered until much later. In such cases, an extension of the statute of limitations, such as that embodied in H.R. 3911, is clearly needed.

However, we favor a broader expansion of the statute of limitations than that contained in H.R. 3911. In the proposed "Anti-Fraud Enforcement Act of 1987," which we transmitted to the Congress on September 23, 1987, and which I will discuss further in a moment, there is a provision which would extend the statute of limitations in cases involving fraud (or a breach of a fiduciary obligation) beyond five years to one year after the facts relating to the offense became known, or should have become

known, to the responsible authorities. The maximum extension beyond five years under this provision would be an additional three years. We believe that this provision, which would apply to procurement cases as well as all other forms of fraud, would properly enhance the government's ability to prosecute all well concealed fraud cases, not just the class of cases addressed by H.R. 3911.

REWARD FOR INFORMATION

The provision contained in H.R. 3911 to reward persons providing information leading to conviction in major procurement cases parallels recently enacted legislation in the narcotics area. While such a provision may encourage spurious claims for rewards in many cases, it may also encourage persons who might otherwise file qui tam suits on behalf of the government to communicate directly with law enforcement authorities. This would lessen the burden on the courts and on the Department of Justice. Accordingly, we support the provision.

"WHISTLEBLOWER" PROTECTION

Congress has enacted two "whistleblower" protection statutes in the last two years, one in the False Claims Amendment Act of 1986 (31 U.S.C. 3730(h)) and the other in the National Defense Authorization Act of 1987 (10 U.S.C. 2409). In no way do we condone or defend retaliatory actions directed against those who

cooperate with our efforts to investigate and prosecute procurement fraud. However, until these two recent legislative efforts are proven necessary or, conversely, inadequate, to achieve their stated goals, we do not endorse the enactment of further legislation which is largely cumulative. We do not believe it is timely to create yet another statutory cause of action in federal court.

Moreover, this provision could conflict with remedial administrative action. When procurement fraud is discovered, the appropriate suspension and debarment authority requires culpable individuals be disciplined by dismissal, removal from management or supervisory positions, or financial penalties as part of the contractor's corrective action. However, in our experience, "whistleblowers" frequently have been involved in the fraudulent activity themselves. In these situations, the bill would negate the application of administrative sanctions on the "whistleblower" and could subject the contractor to civil liability arising out a "whistleblower" suit for complying with the remedial administrative action.

OTHER SUGGESTIONS

We believe other language in the bill can be improved. For example, the "value of the contract" language which triggers the prohibitions of the bill presumably is intended to describe the value of the goods provided and/or services rendered to the

government. It should be stated in those terms. This would apply equally if the "value" trigger applied only to enhanced penalties.

As currently drafted, the intended mandatory term of two years imprisonment in cases involving a risk of personal injury might be interpreted to permit the court to sentence the defendant only to a fine or probation. This provision should be redrafted to provide that in such cases, "the court shall impose a term of imprisonment of not less than two years."

I want to emphasize our commitment to investigating and prosecuting major fraud against the United States. In this connection, on September 23, 1987, we submitted three proposed bills to the Congress: (1) the "Anti-Fraud Enforcement Act of 1987" which I mentioned earlier; (2) the "Contract Disputes Act and Federal Courts Improvement Act Amendments of 1987"; and (3) the "Bribes and Gratuities Act of 1988." We would like the Committee to act on these proposals as soon as possible, since each of these bills would substantially assist our efforts to combat procurement fraud.

I would like to discuss in particular the important provisions of the "Anti-Fraud Enforcement Act of 1987." The amendments to the statute of limitations contained in the bill were described earlier. Another provision would amend Rule 6 of the Federal Rules of Criminal Procedure to permit us to

communicate more freely to the Civil Division and our sister agencies the information gathered in the course of a grand jury investigation. We want to be able to share this information for the purpose of imposing civil and administrative sanctions in fraud and other appropriate cases. This provision is particularly important to us. As an example, a current grand jury investigation of one very large government contractor has disclosed systemic weaknesses which should be addressed forthwith by the appropriate administrative authority. However, because the allegations underlying the investigation were received shortly before the expiration of the statute of limitations, we were compelled by time constraints to take the matter directly to the grand jury and could not utilize other non-grand jury investigative techniques. Accordingly, we are unable to communicate the information we have gathered concerning these problems to the affected agency, and the problems persist without being addressed.

The bill also would expand the government's right to audit contractors' books, permit the government to collect the costs of a successful procurement fraud investigation and prosecution, and eliminate the practice of allocating the costs of successful prosecution to future government contracts.

Two other provisions of the bill, the extension of the injunction provision contained in 18 U.S.C. 1345 to government

fraud cases and the creation of an offense for obstructing a federal audit were passed by Senate on June 17, 1988.

Mr. Chairman, that concludes my prepared statement. I would be happy to answer any questions you or the other members of the Committee may have.

Senator METZENBAUM. I think we are going to hear the next witness because I think it will save some time by doing that. Thank you very much for your testimony.

Our next witness is Richard Fogel, Assistant Comptroller General, General Government Division, GAO.

Ms. TOENSING. Excuse me, Mr. Chairman. If I might just say, Mr. Valukas is here to testify for the Department of Justice.

Mr. VALUKAS. Senator, I was invited, or the Department asked me to speak as the U.S. attorney on behalf of all of the U.S. attorneys in connection with Senate Bill 1958. You have my prepared remarks.

Senator METZENBAUM. I would say, Mr. Valukas, we do not have you down as a witness. The Department of Justice does not really tell us who our witness list is, and had they told us, we would try to work you in. Why don't you make it very brief in order to make your point?

Mr. VALUKAS. I will make it very brief, Senator.

The point we would make with regard to Senate Bill 1958 is simply this: We need additional resources in order to combat the problem of defense procurement fraud. Simply put, each of the offices that are involved in actually prosecuting these cases—and those are the U.S. attorney's offices in the various districts—have committed increasing resources, particularly over the last 2 years.

My district, which is one of the largest districts in the Nation and covers the northern 18 counties of Illinois now presently devotes approximately 5 percent of our resources to the investigation and prosecution of these cases alone. That means that other areas which need prosecutive resources—for instance, drugs, corruption, other white-collar crime—are stripped in order to prosecute these particular cases. So we support the additional resources which would be dedicated to the use in defense procurement fraud cases.

We recommend that you not adopt a proposal that will set up regional task forces. What you will be doing is layering by bureaucracy in the various prosecutive offices. You have regional offices right now. They are called the U.S. attorney's offices in the individual district.

I have submitted a brief chart—and I am moving this along—which shows that in the litigation of fraud cases, and we are talking about Government fraud cases from 1983 to 1986, that of the 18,159 fraud cases that were prosecuted were prosecuted by the U.S. attorney's office. The Department of Justice handled 130 of those fraud cases.

So the area of expertise, the people who are actually making the significant fraud cases, be they in securities fraud, commodities fraud, Government contractor fraud, and all of the other areas, are the Assistant U.S. attorneys who are in the field. And what we recommend to you is that in lieu of the regional strike forces or task forces, which would just create another bureaucracy, that you have dedicated assistant U.S. attorneys, much as you do in the OCDEF program who are dedicated solely to defense procurement fraud cases, that you could report separately on those individuals as you do in the OCDEF program. That would be a much more effective way of putting your most experienced prosecutors who are in the field to task with regard to this significant problem.

That is as fast as I can go, Senator.
[The prepared statement of Mr. Valukas follows:]

STATEMENT

OF

ANTON R. VALUKAS

UNITED STATES ATTORNEY
NORTHERN DISTRICT OF ILLINOIS

BEFORE

THE

COMMITTEE ON JUDICIARY
UNITED STATES SENATE

CONCERNING

FRAUD LEGISLATION
S. 1958

ON

JULY 12, 1988

Remarks of Anton R. Valukas,
United States Attorney, Northern District of Illinois
July 12, 1988

I appreciate the opportunity to address the Senate Committee on the Judiciary concerning S. 1958, legislation to establish government fraud law enforcements units to investigate fraud against the government.

By proposing to set up five regional law enforcement units, S. 1958 would impose a bureaucratic structure, with its attendant administrative and travel costs. Such a plan deprives the most difficult government fraud cases of the wealth and depth of experience of Assistant United States Attorneys who have successfully investigated and prosecuted the most sophisticated economic crimes, not only in the defense procurement area, but in the full range of "white collar" crime.

At the same time, the regional task force concept would take from the newer Assistants the more routine and easily prosecuted government contracts and program fraud cases, which are now routinely assigned to assure that every Assistant is trained to prosecute ever more complex government fraud prosecutions, and to assure that even a "routine" defense fraud case is promptly prosecuted. These same smaller cases, so important to our overall obligation to deter all forms and levels of government fraud, if assigned to a regional government fraud unit under the proposed legislation, might take backseat to the high profile case.

It is clearly the premise of Senate Bill 1958 that there is always an advantage in having an attorney assigned to a case who has previously prosecuted a case in the same narrow category of fraud. I reject that assumption and would maintain instead that in our experience such narrow specialization is ultimately counterproductive.

In my opinion, a good Assistant United States Attorney, experienced in the prosecution of economic crime, and drawn from and with access to a pool of other talented Assistants, is the best choice for every case. A good Assistant can develop the narrow expertise necessary for the individual defense procurement case as the need arises. He or she already has the needed familiarity with the strategic uses of the broad range of criminal and criminal tax statutes, and the imagination to use the proper mix of prosecutive tools -- including undercover agents, search warrants, proffers, immunity and plea bargaining -- to carry out a successful investigation focused on the right targets. He or she has the skill in working with agents to follow up the leads and tips which come daily to a United States Attorney's office which is well known to the community. (These same tips and leads are unlikely to come to any regional task force). Such an Assistant has the trial experience to make reasoned decisions or recommendations about witnesses, evidence, plea agreements and immunity, and the credibility with the defense bar and federal district court to assure that the investigation is controlled by

what we need to know, and not what the putative defendants choose to provide to us.

Moreover, it is important to the credibility of the United States Attorney, and to the administration of criminal justice as a whole within a district, that decisions regarding immunity and plea bargaining be closely supervised within the district and not administered from Washington.

An experienced prosecutor familiar with the tough standards of a local district can overcome the expectation of defense contractors that they can get soft deals if they can just find the right ear in Washington. He or she can also press for pleas of guilty which can foreshorten the expenditure of time and resources in complex prosecutions.

In my view, only when defense procurement contractors know that they must deal with the United States Attorney, and cannot turn to other authority in search of a better deal, will they accept a just disposition of their cases which fairly reflects the extent of their criminal or civil violations. If a corporation and its officers accept that responsibility in criminal and civil negotiations, and fully cooperate with the investigation, their demonstrated contribution should be the major factor in decisions regarding application of the sanction of debarment.

My office has demonstrated in its coordinated prosecutions of judicial corruption, other public corruption cases, bank fraud, tax fraud, tax shelter, bankruptcy fraud, securities fraud and,

indeed, large narcotics cases (which we treat as economic crimes), that it can bring together the resources of many investigative agencies and, when appropriate, the regulatory agencies, to improve the quality of complex prosecutions in the Northern District of Illinois. We have successfully prosecuted almost 250 public corruption cases in the past three years, losing only one. We have prosecuted more than 200 bank fraud cases, losing only one defendant in a multi-defendant case. And we have prosecuted more than 250 tax fraud cases with no acquittals. Indeed, we have not lost a tax fraud case in my district since 1981. In the past year, among complex bankruptcy fraud cases, we successfully completed a multi-million dollar fraud prosecution relating to the administration of bankrupt estates and prosecuted a long series of complex fraudulent tax shelters. We have formed a "bank regulator forum" to bring together the financial institution regulatory organizations with the FBI and Postal Inspectors and United States Attorney representatives to enhance training of examiners and the quality of bank fraud referrals, -- a program which has become a model for other districts. It is that broad experience in prosecuting complex economic crime, and not specific experience in the defense fraud area, which has made us able to take on some of the biggest procurement fraud cases in the country.

There is no question in my mind that no attorney brought out from Washington (and placed in a regional task force), could do the job of investigative prosecution and negotiation and respond

as effectively to the day-to-day needs of the cases as have the Criminal and Civil Assistants in my office, working with the designated agencies to prosecute these fraud cases. Moreover, in one great area of fraud against the government -- welfare fraud -- we also have worked closely with the State's Attorneys to increase the resources available -- a tie which could not be exploited by a regional task force approach.

In the past three years my office has successfully prosecuted approximately fifteen defense procurement fraud cases. We presently have approximately twenty active investigations. The increasing number of cases in the past years are a reflection of increased experience and the increasing commitments of the Department of the Army, Criminal Investigative Division, the Naval Investigative Service and the Defense Fraud Investigative Service to provide the auditors, contract experts and inspectors to successfully prosecute these cases. With additional agents and Assistant United States Attorneys no doubt there would be more cases still.

The cases where prosecution has been completed have ranged enormously in complexity. There have been straight-forward schemes to pay kickbacks to obtain government contracts -- not distinguishable from the hundred other procurement contract kickback schemes we have prosecuted this past year. In an insider fraud case, a Department of Defense employee smuggled out an

advance copy of contract specifications for a micro-computer contract to give a competitive advantage to friends. In a particularly outrageous case, officers, employees and the corporation of American Cotton Yarn Co., the defendants illicitly profited from systematically substituting inferior parachute cord, not meeting strength or elasticity requirements, putting American troops in peril of injury or death.

We now have under investigation four extraordinarily complex cases involving hundreds of millions of dollars in contracts involving allegations of defective products, overcharging and mischarging. Each of the Assistants assigned to direct these four largest cases has previously successfully prosecuted complex securities fraud, bank fraud, government program fraud, tax and tax shelter cases. Based on their experience in other investigations, they have turned to other agencies, such as the IRS, to broaden the investigation and provide computer resources. As the demands of the cases have increased, these Assistants are devoting between 50 and 100 percent of their time to the prosecutions. As needed, other Assistants have been made available. In those cases where it has been appropriate, the Civil Division of my office has likewise provided attorneys experienced in complex litigation and tough negotiations to handle the related civil cases.

Such delays have occurred in these large defense procurement cases have not been because we were not prepared to commit the

attorney power of my office when a case required it. Rather the cases demanded personnel not initially available from the Department of Defense because the Defense Department agencies were increasing their skills and expertise in an area which previously fell within the jurisdiction of the FBI. In one case a large squad of auditors was needed; another required experts who could determine with precision the specifications of the contract and measure the performance or product against the contract. And it has become apparent as we have examined the defense contract fraud cases presented to us for prosecutive decision, that contracting procedures and an improved ability to mobilize information of contracts and contract performance will be necessary to increase the probability of successful prosecutions on cases of fraud.

By my words, I do not want to suggest that we are not continually evaluating our resource needs in order to adequately respond to government fraud. In a complex case such as our recently prosecuted case involving Penn Square loans purchased by Continental Bank, three of my ablest Assistants were absorbed full time for most of a year. As we deal with the demands of a major defense procurement fraud case, we are continuously stripping attorney and support resources from other areas of need. I could estimate that five percent of my resources is now engaged in defense contract related cases. If these defense fraud cases result in trials, that percentage will increase to the detriment of other cases.

We work closely with the Department of Justice. Under the present system there is sufficient flexibility and good will for United States Attorney's offices in need of temporary resources to draw on the Criminal Division for additional technical assistance and attorney help without creating a new structure which absorbs scarce funds at a time when Congress has required that spending be cut back.

To reiterate, it is my essential message that it is the United States Attorney's offices and the investigative agencies which are making the most effective use of available resources. If we are serious about a full fledged assault on government fraud resources must continue to be invested in this area.

I thank you for inviting me to present my views and for your attention.

Senator METZENBAUM. Thank you very much. You did very well, and we certainly get your point. Good witness.

Senator Simon, do you have an opening statement?

Senator SIMON. I do not. Thank you very much. We have a U.S. attorney from the northern part of Illinois here.

Mr. VALUKAS. Good to see you, Senator.

Senator METZENBAUM. Happy to have you with us, Senator Simon.

Mr. Richard L. Fogel, I think I introduced you before. Please proceed.

STATEMENT OF RICHARD L. FOGEL, ASSISTANT COMPTROLLER GENERAL, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, DC

Mr. FOGEL. Yes, thank you, Mr. Chairman.

Let me just very briefly summarize the report that we issued last week to Senators Proxmire and Grassley, and then comment very briefly on the Senator's bill.

We said that four things need to be done in the Justice Department if it is to get better information on how it ought to use its current resources most effectively, and to make a better case for saying why it needs more resources in the defense procurement fraud area. Everyone that we talk to in Justice and the U.S. attorney offices said they need more resources. Our concern is: Do they really know what they are doing with what they have got now?

We said they need complete and timely information on the number and status of defense procurement fraud referrals and cases so that management could better track the progress of investigations, and identify problems. They also need data on attorney resources being spent to enable management to monitor the amount of effort being devoted in this area more effectively. We said they could use written plans and periodic updates of those plans that identify the activities of Justice headquarters and U.S. attorney offices that would allow comparison of planned with actual accomplishments. And we asked them to consider a case weighting system to help distinguish the different prosecutive efforts required for the different types of cases.

I would like to note that the management problems we found in this area are no different than those we generally have found over the years when we reviewed other Justice's programs. We issued an overall report in 1986 about the entire management of the Justice Department. One of the problems we found—based on testimony that was given to us by former senior officials at the Department from numerous administrations—was that there has been a general disinclination on the part of Justice for a number of years to really address management issues. This is not just associated with this administration; it goes back over a number of years. These top officials who were, in fact, blaming themselves for part of this, said that this comes in part from their legal backgrounds and the predisposition to focus on legal issues in selected cases, rather than focusing on the management information and systems that you need to develop priority efforts and follow through on those efforts.

I want to emphasize what Senator Proxmire said. In this area, we have seen the Justice Department working very well in the last couple of years with the Department of Defense to begin initiatives, but developing policies is not enough. You have to focus on policy implementation. That means paying attention to such things as management systems, getting information on what is happening, and deciding whether you are having successes or not so you can make changes in mid-course.

What we see is increased concern within the Department to do these types of things, but on the other hand, we have not yet seen the sustained effort over time that, in our mind, has satisfied us that Justice officials have really got a good handle on how they are devoting their resources.

One last comment on the bill that Senators Proxmire and Grassley have introduced. Obviously, the Justice Department headquarter officials we talked to strongly supported that bill. The U.S. attorneys that we interviewed were unanimously against it. That goes, I think, to the historic relationship that has existed for a long-time in this country between U.S. attorneys and Justice headquarters.

There certainly is a willingness to cooperate, but one suggestion we would have in considering your legislation is that you do look, as Mr. Valukas said, at the way the Department organized the Organized Crime Drug Enforcement Task Force program. This was a fairly successful effort by the Department working with the U.S. attorneys, the Customs Service, various other components within Justice, and other agencies to develop a focus on a specific problem, regionally focused to work with the U.S. attorneys and the Department to devote more resources to it, but to try to overcome some of the organizational problems that have existed in the past between the Justice Department and the U.S. attorney's offices when we have had strike forces.

[The prepared statement of Mr. Fogel follows:]

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Defense Procurement Fraud: Justice's Overall Management Can Be Enhanced

Statement of
Richard L. Fogel, Assistant Comptroller General
General Government Division

Before the
Committee on the Judiciary
United States Senate

GAO/T-GGD-88-46

GAO Form 160 (12/87)

JUSTICE'S OVERALL MANAGEMENT OF DEFENSE PROCUREMENT FRAUD CAN BE ENHANCED

SUMMARY OF STATEMENT BY
RICHARD L. FOGEL
ASSISTANT COMPTROLLER GENERAL
GENERAL GOVERNMENT DIVISION
U.S. GENERAL ACCOUNTING OFFICE

In response to a congressional request from Senators Proxmire and Grassley, GAO reviewed Justice's overall management of its defense procurement fraud investigations. GAO found that Justice's overall management could be improved if it had basic oversight information on its decentralized operations. Justice needs to acquire the following information to improve its oversight of this high priority area.

-- Complete and timely information on the number and status of defense procurement fraud referrals and cases would enable management to better track the progress of investigations and identify problems.

-- Data on attorney resources being spent would enable management to monitor the amount of effort being devoted to this area.

-- Written plans and periodic updates of those plans that identify the activities of Justice headquarters and the U.S. attorney offices would allow comparison of planned with actual accomplishments.

-- A case weighting system to help distinguish the different prosecutive efforts required for different types of cases could help management assess and identify its resource needs.

GAO made several recommendations to the Attorney General designed to provide Justice with better information so that management can make more informed decisions regarding the allocation and use of scarce resources.

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss the findings in our June 29, 1988, report entitled Defense Procurement Fraud: Justice's Overall Management Can Be Enhanced (GAO/GGD-88-96). Our review, which was requested by Senators Proxmire and Grassley, did not focus on specific cases or the current bribery investigation being handled by the U.S. Attorney in Alexandria, Virginia. It involved a broader look at Justice's strategy for coordinating and managing the defense procurement fraud effort among the 93 U.S. Attorneys and the Criminal Division's Defense Procurement Fraud Unit. In doing our work, we interviewed officials from Justice headquarters, seven U.S. attorney offices, and Department of Defense auditing and investigative agencies. We also reviewed work load and other statistical data from the agencies' various management information systems.

BACKGROUND

The Criminal Division at Justice headquarters and the U.S. attorney offices are responsible for the criminal prosecution of defense procurement fraud. The Criminal Division's Defense Procurement Fraud Unit, which was created in 1982 to focus Justice and DOD resources on defense procurement fraud, is supposed to initially receive and review for prosecutive merit all referrals submitted by investigative and auditing agencies involving significant instances of alleged defense procurement